

**THE RECORD INDUSTRY AND COMPETITION LAW IN
THE TWENTY-FIRST CENTURY**

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THE RECORD INDUSTRY AND COMPETITION LAW IN
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Abstract

This research argues for recognition of the importance of cultural industries and cultural diversity and their special treatment by competition law. It uses the record industry as a tool to demonstrate how independent music labels contribute to diversity in a record business dominated by four major players. Whilst some scholars have advocated the inclusion of cultural issues under competition law, no concrete suggestions have been made as to how exactly to do that and no study has been made to determine what pitfalls may lay in doing so. This thesis deals with the lacuna by adopting a number of approaches and shows why cultural industries require special protection by competition law. The aforesaid is the unique feature of this thesis, which should help bridge the existing gap between theory and practice.

In order to address the research question, a three-stranded methodological approach is utilised. Firstly, the historical analysis demonstrates the different competitive dynamics of the record industry since its inception, and it shows that musical diversity generally increased when the industry concentration was low. Secondly, the legal analysis focuses on the EU merger test and Article 81 of the EC Treaty; the US approach is also analysed for comparative purposes. Legal analysis examines how competition law has dealt with the regulation of competitive dynamics in the record industry, drawing analysis from a number of mergers and acquisitions, most notably the merger wrangling between Sony and BMG lasting for 5 years overall. Thirdly, qualitative interviews probe into why independent labels are important and what effect the recent mergers had on the independent sector.

The main finding of this study is that cultural diversity can be incorporated into the EU merger test as well as Article 81(3) of the EC Treaty as a non-competition concern and therefore should be taken into account by decision-makers.

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I declare that all the material contained in this thesis is my own work

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“Life is not so idiotically mathematical that only the big eat the small; it is just as common for a bee to kill a lion or at least to drive it mad”.

August Strindberg¹

“Music, of all the liberal arts, has the greatest influence over the passions, and it is that to which the legislator ought to give the greatest encouragement”.

Napoleon Bonaparte²

Introduction

This study focuses upon whether or not cultural industries³ deserve special treatment by competition law and if so, to what extent competition law has thus far managed to protect cultural diversity? The research seeks to demonstrate that competition law should treat cultural industries as a special case because the law has so far failed in preventing high concentration within them, in turn leading to the reduction of cultural diversity, which in terms of this study embraces the diversity of both products and producers.⁴ The record industry is used as a vehicle to demonstrate and prove the argument.

The work is based on the most up-to-date opinions of scholars and leading figures within the record industry. Its uniqueness and originality lie in the fact that I⁵ argue in favour of the incorporation of non-price and non-economic considerations into the new merger test and Article 81 (3) of the EC Treaty to protect the diversity of producers, and thus, cultural diversity. Also challenged are some of the perceived stigmas and stereotypes of major and independent labels. For example, the ideas of majors caring only about their profits and independents caring only about music and artists are examined; such clichés are put to the test. The backdrop to this study is that

¹ August Strindberg, *Miss Julie*, translated by Michael Robinson (Oxford: Oxford University Press, 1998), 57.

² Also cited in Tryon Edwards, *A Dictionary of Thoughts* (Warwick: Read Books, 2008), 367.

³ For the definition of cultural industries see Section 1.1.

⁴ For the detailed analysis of cultural diversity see Section 1.7.

⁵ Although it is more normal to use the third person, as this study comes from the ethnographic tradition, the first person approach to writing was adopted where necessary.

competition law's effect on cultural industries has been previously under-researched; this work seeks to remedy the situation and contribute to both the academic debate and the application of competition law in practice.

This introduction presents an overview of the research problem, an indication as to why the problem was worth exploring and what contribution the proposed study will make to theory and practice. Additionally the context for the thesis as a whole is set.

The rationale for the research question and the study was to evaluate the impact of competition law on cultural industries and diversity, with the synopsis of the arguments being that culture and cultural products should not be treated by law in the same way as for example, chemical, commodities or car industries; and that competition law has failed in protecting cultural industries exactly for this very reason; because it applies the same legal tests (price competition) when regulating cultural industries. The study illustrates that it is actually *non-price* or *non-economics* based competition that is more important and relevant than price competition when assessing the concentration levels within cultural industries.

Before going into further explanation of the research, I would like to explain what inspired me to carry out this work. Back in 2003, one of my favourite bands, Simply Red, released their new album on their own label after leaving a major label, East/West (an imprint of Warner Records). That was one of the first successful examples in the digital age of an established artist leaving a major record company to start his own risky venture, and understandably it generated vast media interest. This prompted my initial interest and I questioned why an established artist or band would ever want to leave such a 'safe harbour' like a major record company? Being a big fan of modern mainstream culture, I also appreciate that there is a lot more great art out there that audiences do not have a chance to hear or see. For example, the big seven Hollywood studios dominate 90 percent of European screens.⁶ Therefore, the usually high quality independent films tend not to be played on European mainstream TV and cinema screens.⁷ Obviously, there is always an exception,⁸ but it is not to society's benefit that

⁶ Christophe Germann, "Content Industries and Cultural Diversity: The Case of Motion Pictures," in *Cultural Imperialism: Essays on the Political Economy of Cultural Domination*, ed. Bernd Hamm and Russell Smandych (Peterborough, Ont: Broadview Press, 2005), 93.

⁷ This should be seen in contrast to the US, where less than 3 percent of foreign films are shown in cinemas and on TV. *id.*, at p. 93.

such things happen to be the exceptions rather than the rules. Hence, my other main query with respect to music was why do both radio and television broadcast a limited number of artists and what effect does this limitation have on cultural diversity? That question had to be considered in the light of a huge wave of mergers and acquisitions in the record industry during 2004 – 2008 alone.

I embarked on this research in 2004, and I like to think that it crystallised into a study that contributes to both theory and practice. In 2005 I started working in the record industry as a researcher, and afterwards as an artist manager. The experience expanded my horizons and eased my access to leading music industry experts.

Ironically, these events evolved around 2004 when the two out of the then five major record companies, Sony and BMG, merged their businesses with the blessing of the European Competition Commission (hereinafter, the Commission), generating an outcry from the independent label sector. What I could not predict was that this very merger would be used in the study as an example to help me answer the research question. At the time, independents showed their teeth by successfully opposing the merger at the Court of First Instance (hereinafter, the CFI) at the European level in 2006, but SonyBMG could not give up without a fight, which culminated in the second approval of the merger by the Commission in 2007. In 2008, as I was approaching the submission date, Sony acquired a 50 percent stake in BMG. The described wrangling allows one to appreciate the uncertainty I faced when carrying out this research. Serendipitously, help came with the investigation of this very merger by the European Parliament, which wanted to look into the effect of the merger on small businesses in the cultural sector and diversity of cultural products. The European Parliament, showing particular interest in cultural diversity and the merger between Sony and BMG timely coincided with my research, and gave it a much wider perspective.

Despite the fact that there has been a lot of media coverage of the Sony/BMG merger, it became evident that no sustained work had been carried out on whether competition law should be used as an instrument to regulate cultural industries. There has been a vast amount of research conducted concerning the connection between the concentration of

⁸ For example the Curzon Cinema in London, that specialises in non-mainstream movies.

cultural industries and its effect on diversity levels, but that is a different research question.

It is important to note that this work is not intended to be a ‘bashing big business’ treatise. Indeed, some even argue that big corporations are integral to the existence of popular music,⁹ although today the Internet and new technologies do exert a democratising influence. All in all for better competitive dynamics, big business should be able to co-exist with small business. However, this study argues that the market share and power of four record companies, Universal, Warner, EMI and Sony (currently 75 percent of the market share worldwide) have to be balanced in the interests of cultural diversity and consequently, the public.

As the nature of this research presents both legal and sociological insights, the study begins with Chapter 1, *Orientation and Context*, which introduces the antecedents of academic opinions on cultural industries, the value of cultural diversity, and the legal underpinnings of the study. Chapter 1 explains what cultural industries are, by combining related insights from the production and consumption of culture. Also illustrated is that the consumption patterns in the modern record industry are more complicated than presumed without a thorough, in-depth study. The review in addition shows that in many industries, especially cultural industries, innovation and diversity are prominent features of the competitive process and are closely related to concentration levels. Hence, it was necessary to investigate the connection between market structure and diversity. The majority of the research carried out by other scholars indicates that high concentration within cultural industries, the record industry in this particular case, is *inversely* correlated with levels of diversity, i.e. the higher the concentration, the lower the diversity.

Chapter 2, *Methodology*, gives both a theoretical background presentation and the method utilised and follows the introduction to the main issues described in Chapter 1. The three-stranded approach to the research is described: historical study, legal study, and interviews.

⁹ Jon Stratton, “Capitalism and Romantic Ideology in the Record Business.” *Popular Music* 3 (1983): 143.

As this research is focused on the record industry, Chapter 3, *History of Competitive Dynamics and Growth in the Record Industry*, takes the reader through the various competitive dynamics pertinent to the industry, both backing up the research provided in Chapter 1 and proving that in practice, music diversity diminished when industry concentration was high. This historical background is a unique study because the description illustrates the different evolutionary stages of the record industry that were tied in with corresponding competitive dynamics, i.e. oligopolistic and competitive market structures. Also underlined are the crucial differences between big and small businesses in the record industry. The position taken is that the majority of independent labels are *qualitatively* different from major record companies. Later, this very argument is used to show that the diversity of products and producers need to be protected by competition law. Finally, Chapter 3 also highlights the importance of small and medium-sized businesses in the record industry, elucidating why competition law should protect the diversity of producers.

Since the crux of this study is the high concentration apparent in the record industry, it was deemed necessary to investigate what was and still is, the main reason for majors to merge with each other and acquire independents. Whilst competition law is a major part of the thesis, the central underpinning of the record industry is intellectual property. As such there is a synergy between competition law and the idea of protecting diversity in relation to intellectual property. To fully understand the competition aspects of the record industry, it is first necessary to deal with intellectual property as far as the record industry is concerned. It is important to note that the record industry is based on copyright creation, acquisition, and rights transfers. These elements are dealt with in Chapter 4, *The Rationale behind Mergers and Acquisitions and Resultant Anti-competitive Behaviour*, which firstly analyses the role of copyright in the consolidation process and the way that both majors and independents approach the extension of copyrights in sound recordings. The chapter also highlights the polarised aims of the competition and copyright legal regimes, with the former seeking to prevent monopolies, whilst the latter actually granting monopoly rights. Following the analysis of copyright's role in giving majors market power, other reasons for mergers and acquisitions in the record industry are provided.

The fact that four major record companies with a market share of 75 percent dominate the recorded industry market is not a problem in terms of competition law (it is

problematic though in terms of diversity). Rather it is the fact that majors might abuse this market power that warrants an investigation. In this respect it is important to illustrate examples of anti-competitive behaviour that major record companies have exercised in the past and still do exercise at present.

Following on, the legal safeguards in protecting cultural diversity are analysed in Chapter 5, *Past and Existing Jurisprudence in Merger Regulation*, which firstly considers the account of the past merger test.¹⁰ Every single merger decision in terms of the record industry in the EU to date has been based on that test. Furthermore, the new merger test is analysed to hypothesise its capability to deal with cultural industries in the future. As major and numerous independent labels span across the United States too, for the sake of comparison, the US merger test was also assessed to investigate if it was better suited to deal with cultural issues. The chapter proceeds to critically analyse the merger between Sony and BMG allowed by the Commission in 2004 as well as its annulment by the Court of First Instance in 2006 and its second approval by the Commission in 2007. The analyses of these rulings contain the first strand of criticism as to the way the Commission applied the past merger test (the second strand of criticism is contained in the Conclusion). These unique analyses are, in addition, used as a necessary base to explain in Conclusion why the Commission should take on board non-price or non-economic considerations when dealing with cultural industries. To date, investigation of the above case law has been very sparse and this thesis will add considerably to the pool of knowledge in the area.

Having assessed the jurisprudence under the merger regulation, Chapter 6, *Articles 81 & 82 of the EC Treaty and Other Legal Tools Accommodating the Diversity of Products and Producers*, proceeds to investigate to what extent those avenues could protect cultural diversity, small businesses, and consumers. Article 82 is only briefly assessed because it was effectively made more or less defunct by the new merger regulation.¹¹

¹⁰ The submission of the thesis took place before the Treaty of Lisbon came into force on the 1st December 2009. Most of the substantive provisions of the EC Treaty remain unchanged. However, it made some changes to both the terminology and the numbering of key provisions. The Treaty of Lisbon replaced all references to 'European Community' by 'European Union'. The EC Treaty has been renamed as the Treaty on the Functioning of the European Union (the TFEU). The European Court of Justice is now known as the Court of Justice of the European Union and the Court of First Instance has been renamed as the General Court. Article 81 of the TFEU was re-numbered to now be Article 101, whilst Article 82 was re-numbered to now be Article 102.

¹¹ The new merger regulation introduced the collective dominance test, which arguably replaced the dominance test under Article 82 (collective dominance test is analysed in Chapter 5).

Article 81, however, is analysed in far greater detail exploring, by analogy, the book price-fixing system in terms of whether or not such non-economic considerations as cultural issues could and should be taken on board under Article 81 when dealing with cultural industries.

Finally, the *Conclusion* contains the findings supporting the assumption that competition law fails in preventing the high consolidation of cultural industries. Following on, the Conclusion sums up the criticism related to the existing merger regulation test itself. This line of criticism is backed up by the second approval of the Commission of the Sony/BMG merger in 2007 and its investigations by the European Parliament and its Culture Committee in late 2007 and 2008. The study concludes that it is incorrect for both the Commission and the CFI to apply the existing merger test that only takes into account *price-based* competition, which is to a greater degree irrelevant to the record industry in the digital age. The analyses contained in all the previous chapters support the finding of this study, namely that competition law, i.e. its merger test and Article 81 of the EC Treaty, should take on board *non-price* competition and non-economic considerations when dealing with cultural industries as those are more relevant to the industry. Following that, possible ways to modify and improve the existing merger test and Article 81 are discussed. Finally, some concluding remarks suggesting other, informed ways to diminish the high concentration of cultural industries, are provided.

Chapter 1: Introduction: Orientation and Context

Before looking into the theoretical issues, it is necessary to consider some of the guiding threads, i.e. the academic work around cultural industries, diversity, and regulation. Clarifying the relationship between the study and previous work conducted on the topic will also help to further demonstrate why the proposed study is both important and timely. Explained in this chapter is how the study is distinctive and different from previous research by unpacking the main concepts that penetrate the work; namely cultural industries, cultural products, cultural production and consumption, diversity, globalisation and regulation. Also explained is why cultural industries are of a specific nature and deserve special treatment by competition law. The review is conducted within the context of contemporary debates and places historical work in its context.

1.1. Cultural Industries: Definition and Significance

As a starting point, the meaning of culture, along with its importance and place, should be defined. Etymology indicates that the word ‘culture’ refers to the cultivation of the soil;¹² ‘cultura’ has its roots in Latin ‘colere’ – to cultivate. From the fourteenth century until the present day the meaning of culture has spread to other areas, including the development of human subjectivity and the intellect.¹³ Evidently, the concept of culture is associated not only with intellect but also with numerous manifestations of individual endeavours. As Raymond Williams noted “the modern history of the concept of culture is in fact a history of the search for such a concept”.¹⁴ Particularly today, culture may mean beliefs, dress, religion, manners, and other attitudes to life, e.g. gun culture. However, in terms of this thesis ‘culture’ signifies the *arts*: music, art, books, films etc. Defining culture in this sense can be problematic but not impossible. For example, Simon During defined culture “...not as a thing or even a system but a set of transactions out of which music, poems and films are produced, to be experienced and given meaning and value in different ways”,¹⁵ whilst Matthew Arnold gave his

¹² David Throsby, *Economics and Culture* (Cambridge: University Press, 2001), 3.

¹³ id., at p. 3.

¹⁴ Raymond Williams, *Culture* (London: Fontana, 1981), 206.

¹⁵ Simon During, *Cultural Studies: A Critical Introduction* (London: Routledge, 2005), 6.

wide view of culture as “the best that has been thought and said in the world”.¹⁶ Therefore, to this day culture (arts) is strongly connected with the cultivation of the mind and has a great impact on society.

Having considered the meaning of culture in terms of this thesis, the next step is to find out what is meant by another notion - ‘cultural industries’. Theodor Adorno and Max Horkheimer of the Frankfurt School first coined the term ‘culture industries’, which presents the foundation of this study, in 1947. For the purpose of this study however, the more modern version of the term, cultural industries, is used instead.¹⁷ The backdrop to cultural industries is that businesses, be they big or small, connect a cultural product with its consumer, hoping to make a profit. This shift in cultural production from an almost ‘cottage industry’ stage to an industrial stage is in itself problematic and is referred to as the commodification¹⁸ of cultural forms such as film, radio, books and music. Indeed, the term ‘cultural industries’ already arguably contains a contradictory relationship between creative forces and industrial production. The industrialisation of culture can be described as a process by which “... massive market interests have come to dominate an area of life which, until recently, was dominated by individuals themselves”.¹⁹ In addition to industrialisation, two other problem areas pertaining to cultural industries are: firstly, the high concentration of market power in a handful of players and secondly, their globalisation as the cultural sector for the past century has constantly been absorbed into large industrial conglomerates. Consequently, in order to survive, large cultural firms have to adapt to business logic, with the most prominent one being the economies of scale. These economies lead to the standardisation of cultural products; thus financial gain becomes the “raison d’être” of cultural industries. The duality of cultural practice in the modern age is expressed in that “culture is itself a discourse of capitalist practice”.²⁰ This explains why the relationship between popular culture and commerce is so problematic²¹ and is one of the themes that run throughout this study.

¹⁶ Matthew Arnold, *Culture and Anarchy* (Cambridge: Cambridge University Press, 1960), 7.

¹⁷ In the UK the government’s preferred term is ‘creative’ industries. See for example, *Department for Culture, Media and Sport*, “UK Creative Industries Mapping Document.” (1998).

¹⁸ This is discussed further in Chapter 4.

¹⁹ Anthony Briggs, “Fisher Memorial Lecture.” University of Adelaide, 1960. Also cited in Nicholas Garnham, “Contribution to a Political Economy of Mass-communication.” *Media, Culture and Society* 1 (1979): 145-146.

²⁰ Stratton, *supra*, n. 9, at p. 145.

²¹ See for example, Francesca Martin, “Get in Tune with Pop Culture if You Want to Survive, BBC2’s Culture Show Told,” *The Guardian*, February 14, 2007.

In producing their theory of cultural industries, Adorno and Horkheimer borrowed from Freud, the deep-rooted psychological and socio-economic conflict (in that individuals will oppose social demands that appear to be repressive) and from Marx, the idea of capital.²² Being the first to highlight the interplay between culture and capital as important and problematic, they emphasised the transformation of culture by both the technology and the ideology of capitalism, specifically the ever-increasing desire of profit making was transferred “naked onto cultural forms”.²³ The record industry too was no exception to this philosophy with records being produced by major record companies with the sole aim of making a profit. Even in his later works, Adorno kept insisting, “the venerable profit motives of culture have overgrown the whole culture like a fungus”.²⁴

The point that Adorno and Horkheimer emphasised was that a previously independent sphere such as culture, became industrialised and instrumental in the hands of highly concentrated cultural industries indicating the book, film and record industries. Thus culture, previously “a source of edification, the building of human potential, turned into a machinery of control, whose main goal was the expenditure of resources in the interests of the financial profitability of corporate oligopolies”.²⁵ This view highlights the danger that culture, previously associated with the cultivation of the mind, became objective like other products. The relationship between cultivation of the human mind and financial gain has become the central theme in the critique of cultural industries: in chasing mass markets, diversity suffers.²⁶

Having said that, not all scholars have been unanimous in their negative assessment of cultural industries. It seems that Throsby was one of the few cultural theorists who believed that the term ‘cultural industries’ should have not “... implied any ideological or pejorative judgment, or any economic motive on the industry participants”.²⁷

²² Deborah Cook, *The Culture Industry Revisited: Theodor W. Adorno on Mass Culture* (London: Rowman & Littlefield, 1996), 1.

²³ Theodor W. Adorno, “Culture Industry Reconsidered.” *New German Critique* 6 (1975): 13.

²⁴ Theodor W. Adorno, “Theory of Pseudo-Culture.” *Telos* 95 (Spring 1959): 27.

²⁵ Scott Lash and Celia Lury, *Global Culture Industry: The Mediation of Things* (Cambridge: Polity Press, 2007), 2.

²⁶ Paul DiMaggio, “Can Culture Survive the Marketplace?” *The Journal of Arts Management and Law* 13, no.1 (1983): 84.

²⁷ Throsby, *supra*, n. 12, at p. 111.

Going back to Adorno, he expressed great concern at the way culture was produced and he was not alone in this view. Other scholars echoed Adorno's concerns; most notable of those was F.R. Leavis whose predicament was that he saw culture in crisis.²⁸ However, his idea of "civilisation and culture coming to be antithetical terms"²⁹ seems too radical. Another scholar, Antonio Gramsci, inspired by Marx's ideas, also linked economic production with cultural theories. In his article *Americanism and Fordism*,³⁰ he compared the methods of mass production in cultural industries with the conveyor type methods used in car manufacturing by the Ford Motor Company. Gramsci argued that it was the system of mass production employed by Ford that led to the transformation of a culture, resulting in its commodification. However, the modern view of cultural production has shifted towards post-Fordism, i.e. after the 1970s, cultural corporations began outsourcing ideas as well as staff from other craft-based enterprises (further discussed in Chapter 3).³¹ That aforesaid scenario prompted the point of view espoused by academics that any analysis of culture would only be pertinent if the study was carried out considering the parallels of those who manufacture cultural products.³²

Since then, a different way of looking at culture within a broader economic sense has emerged. For example, Jean Baudrillard³³ located culture in a shifting universe of tangible and intangible social and economic phenomena. The world of economics, according to Baudrillard, inseparably combined culture and capital. The view, to a degree, finds support in this thesis.

²⁸ Frank Raymond Leavis, *Mass Civilisation and Minority Culture* (Cambridge: The Minority Press, 1930), 4.

²⁹ *id.*, at p. 26.

³⁰ Antonio Gramsci, *Selections from the Prison Notebooks* (London: Lawrence & Wishart, 1971), 277 - 318; Kenneth Thompson, "Regulation, De-regulation and Re-regulation," in *Media and Cultural Regulation*, ed. Kenneth Thompson (London: Sage Publications, 1997), 15.

³¹ David Hesmondhalgh, "Flexibility, post-Fordism and the Music Industries." *Media, Culture & Society* 18 (1996).

³² See Keith Negus, "Cultural Production and the Corporation: Musical Genres and the Strategic Management of Creativity in the US Recording Industry." *Media, Culture and Society* 20 (1998): 359; Douglas Gomery, *The Hollywood Studio System* (New York: St. Martin's Press, 1986); David Bordwell and Janet Staiger, "Technology, Style and Mode of Production," in *The Classical Hollywood Cinema: Film Style and Mode of Production to 1960*, ed. David Bordwell *et al.* (New York: Columbia University Press, 1985), 474; James Robbins, "Organization as Strategy: Restructuring Production in Film Industry." *Strategic Management Journal* 14 (1993): 103.

³³ Jean Baudrillard, "The System of Objects," in *Selected Writings*, ed. Mark Poster (Stanford: Stanford University Press, 2002), 13; Jean Baudrillard, "The Consumer Society," in *Selected Writings*, ed. Mark Poster (Stanford: Stanford University Press, 2002), 32.

One of the arguments that dominate this study is that cultural industries are different and therefore, should be treated differently by the competition legislation and authorities, from say, the automobile, textile, and oil industries. The argument then asks the question of what makes those industries so different? Indeed their importance is that they provide education, enlightenment, cultivation of self-determination and individuality, as well as value formation. Both the importance of cultural industries and their special status was re-emphasised by F.R. Leavis in his seminal work, *Mass Civilisation and Minority Culture*:

“If the worst effects of mass-production and standardisation were represented by Woolworth’s there would be no need to despair. But there are effects that touch the life of the community more seriously.... When we consider, for instance, the processes of mass-production and standardisation in the form represented by the Press, it becomes obviously of sinister significance that they should be accompanied by a process of levelling down”.³⁴

Therefore, the protection of cultural industries, namely the diversity of their products and producers, represents a legitimate task. The next issue concerning the above is that of understanding the nature of cultural industry products. The explanation below should be borne in mind during the later discussion on the complexity and dual nature of cultural products (see Chapter 6).

1.2. Cultural Products

As demonstrated above, the basis of cultural industries is that of culture becoming an industrialised economic activity as the result of mass production and standardisation of cultural products. Indeed, in ancient and medieval times as well as during the early stages of capitalism, the output of culture was referred to as art, music, paintings, and literature. In modern times, the preferred descriptions for all of those activities are cultural products, goods or even services. In this respect, the situation does beg the question of what are cultural products and what makes them so different from pure industrial products? Article 4 of the United Nations Educational, Scientific and Cultural Organisation’s (hereinafter, UNESCO) Convention on Diversity of Cultural Expressions³⁵ defines cultural products as those that “embody or convey cultural

³⁴ Leavis, *supra*, n. 28, at pp. 7 – 8.

³⁵ Convention on the Protection and Promotion of the Diversity of Cultural Expressions, October 20, 2005.

expressions, *irrespective* of the commercial value they may have”. This study argues that cultural products (films, TV programmes, music, books etc.) are different from commodity products in that “they serve a cultural function as opposed to a material one”.³⁶ Fiske provided a good example of this by comparing jeans with music: in the case of jeans, their main function is to be utilitarian and fashionable, music however appeals to more personal emotions.³⁷ Therefore, the main difference lies in the emphasis one makes on either money or spiritual and emotional values and meanings. Hirsch echoed Fiske by arguing that cultural products have “a non-material nature, directed at mass consumption, serving an aesthetic rather than a clearly utilitarian purpose”.³⁸ David Throsby suggested that cultural products are the ones that possess the following characteristics:³⁹

- They should carry a creative element in their production.
- They should embody a symbolic meaning when consumed.
- They should possess some form of intellectual property, for example copyrights.

Therefore, cultural products should be valued for their ‘originality and uniqueness’⁴⁰: “every book must have an author, every score a composer, every film a writer, director and cast of actors, unlike cans of peaches, lines of cars and shirts on a shop rack where the direct producers of these commodities are entirely unknown to their purchasers”.⁴¹ Cultural products are important as they provide so-called ‘social cement’ and are responsible for critical faculties and value development. Arguably, cultural products should not solely be for entertainment as they bear an ideological meaning too. They cannot be qualified as “a pure content neutral merchandise, but must also be considered as a vehicle to carry ideas, ideologies, opinions and values”.⁴²

However, there are a number of problematic areas in respect to cultural products. Whilst the products can communicate values and emotions directly across many listeners, viewers and readers, there exists a diametrically opposed force;

³⁶ John Fiske, *Understanding Popular Culture* (Routledge: London, 1989), 11, 26-27.

³⁷ *id.*, at p. 11.

³⁸ Paul Hirsch, “Processing Fads and Fashions: An Organisation – Set Analysis of Cultural Industry Systems.” *The American Journal of Sociology* 77, no. 4 (1972): 641.

³⁹ Throsby, *supra*, n. 12, at p. 4.

⁴⁰ Bill Ryan, *Making Capital from Culture: The Corporate Form of Capitalist Cultural Production* (Berlin: Walter de Gruyter, 1992), 28.

⁴¹ *id.*, at p. 45.

⁴² Germann, *supra*, n. 6, at p. 94.

commodification, which both restricts and controls the circulation of cultural products.⁴³ The following study will demonstrate, that there is a vast amount of music being recorded and released every day but only a minute proportion of it is being heard. Another problem with cultural products is that there is a lack of consensus as to the measurement of their quality and diversity⁴⁴ (this is discussed below). This uncertainty in measurement actually stems from the terms ‘culture’ because it is a qualitative concept that does not provide precise definitions. To many, culture means different things. However, even though some may say that it is difficult to define the word ‘culture’, in this research it is argued that culture may be divided into separate constituent parts and music, for example, is one of them. Similarly, the record industry does represent a definable part of cultural industries and can easily qualify as a purveyor of these products.

Another important feature of cultural products worthy of mention in this study is that they are not separable from the act of producing. This fact is the backbone to the thesis because the numerous record labels are the agents of production; they are not the artists themselves. It would be incomplete to consider only the artists as part of the cultural show, leaving out the producers. This is a conceptual issue because in this study *record labels* are argued to be associated with the protection of cultural diversity. It is not exactly uncontroversial to consider the record companies as part of the cultural diversity issue as there are many other agents in the record making chain, e.g. sound engineers and accountants. However, these other agents do not have a say as to the *shape*, the *nature* and the *product* itself like the record labels.

This section has explained the nature of cultural products and has indicated the link between cultural products and the act of production. The next section will explore the link between culture and economics and show how strongly they are connected in the modern age but that culture should, nevertheless be protected for its cultural, not its economic value.

⁴³ Michael Featherstone, *Consumer Culture & Postmodernism* (London: Sage, 1991), 17.

⁴⁴ Joe Lampel *et al*, “Balancing Act: Learning from Organising Practices in Cultural Industries”. *Organization Science* 11, no. 3 (2000): 268.

1.3. The (Im)perfect Markets of Cultural Industries

Unsurprisingly, the record industry generates many debates concerning commercialism. The potential for making profits within the industry is huge and as Garnham observed, under capitalism, economics determine everything.⁴⁵ The prevalent academic opinions find the economy to be in some way at odds with culture but the reality is that it is vitally important, especially in this industry, that both the economic and the cultural analyses are considered and thus analysed together. For example, there has always been an attempt to connect cultural industries with the economy and their importance for the Gross Domestic Product (hereinafter, GDP) or Gross Value Added (hereinafter, GVA).⁴⁶ The position is evident in the DCMS' Mapping Document, which states, "the creative industries occupy an increasingly important place within the national economy; however their importance is not yet widely recognised"⁴⁷ (the economic importance of the record industry is discussed further in Chapter 3).

As indicated at the beginning of this chapter, on the one hand the term 'cultural industries' carries with it a quantitative dimension in terms of profit making and other economic benefits, e.g. generating employment opportunities.⁴⁸ On the other hand, the term contains a qualitative category - culture. The idea of art or culture becoming industrialised is difficult to reconcile; the fact that such industrialisation does exist focuses attention on the way cultural products are produced and disseminated.⁴⁹

The juxtaposition between art and capital in cultural industries has always been a heated topic amongst scholars. For example, Garnham insisted that cultural industries' industrialisation being a direct result of capitalism, should be acknowledged. In proving his point, he borrowed Marx's notion of base and superstructure claiming that "the cultural superstructure was dependent upon and determined by the base"⁵⁰ and the former had collapsed into the economic base: "under monopoly capitalism the

⁴⁵ Garnham, *supra*, n. 19, at p. 125.

⁴⁶ Cultural industries make a contribution of about 8 percent of GDP to the UK's economy. *Department for Culture, Media and Sport*, "New Proposals to Boost the Creative Economy." (2006); *Department for Culture, Media and Sport*, "Government Response to the Culture, Media and Sport Select Committee Report into New Media and the Creative Industries." (2006), at p. 1; and *Department for Culture, Media and Sport*, "Creative Industries Economic Estimates Statistical Bulletin." (2009): 1 – 15.

⁴⁷ *Department for Culture, Media and Sport*, *supra*, n. 17.

⁴⁸ Throsby, *supra*, n. 12, at p. 111.

⁴⁹ *id.*

⁵⁰ Garnham, *supra*, n. 19, at p. 126.

superstructure becomes precisely industrialised”.⁵¹ However, some disagree with such an approach. For example, Kenneth Thompson argued that culture enjoyed “some relative autonomy”⁵² from economic forces. DiMaggio also pointed out that “...we need not worry about the survival of culture, because culture always survives. What we really are concerned about is the sort of culture that will survive”.⁵³ Overall though, it is not disputed that economic factors have played a significant role in the production of culture for the past 50 years.

The brief analysis above demonstrates the fraught relationship between culture and economics in the modern age. The opinion of Ruth Towse is of particular interest in this respect: cultural industries should be protected for their cultural not their economic potential.⁵⁴ Towse rightly saw no point in making certain areas of cultural industries protected solely because of their economic might.⁵⁵ This view will be addressed again in the concluding remarks of the thesis.

The investigation into the production patterns of cultural industries and their economic power has outlined the pessimistic conclusions reached by cultural elitists as to how corporations exercise their power over consumers. However, what should not be forgotten is the human factor.⁵⁶ Therefore, the following section investigates the consumption patterns in cultural industries.

1.4. Always Mass Consumption?

Having reviewed the literature in relation to consumption patterns, it is obvious that there is a dualism in the notion of mass-culture consumption. Whilst one small camp (cultural optimists)⁵⁷ believes that if a consumer wants to find something non-

⁵¹ *id.*, at p. 130.

⁵² Thompson, *supra*, n. 30, at pp. 11, 29.

⁵³ DiMaggio, *supra*, n. 26, at p. 65.

⁵⁴ Ruth Towse, “Cultural Economics, Copyright and the Cultural Industries” (2000), 107. Conference paper for “the Long Run” at Erasmus University Rotterdam.

⁵⁵ *id.*

⁵⁶ Keith Negus, *Music Genres and Corporate Cultures* (London, Routledge, 1999), 15 - 17.

⁵⁷ The cultural optimists are represented by scholars such as Tyler Cowen and Herbert Gans. For more details see Herbert J. Gans, *Popular Culture and High Culture* (York: Basic Books, 1999) and Tyler Cowen, *In Praise of Commercial Culture* (Cambridge: Harvard University Press, 1998).

mainstream, he or she will always find it; the others (cultural pessimists)⁵⁸ insist that the general public will always accept and only buy what is on offer from an oligopolistic cultural industry.

It would be incorrect to brand modern culture as good or bad. Cultural appreciation is indeed subjective. Interestingly, as a counter argument to the cultural pessimists' idea that large corporations are anathema to real culture, they are confronted with the rock'n'roll phenomenon of the mid 1950s. Even though some cultural optimists provide over-glorified opinions on the state of modern culture, they are right in that *not* all modern culture released by multi-national corporations is bad. The argument can be supported by the fact that, for instance, the Beatles and Barbra Streisand have moved into a different league of popular culture.⁵⁹ More importantly, as this study emphasises, modern culture is not just about pop or rock music released by big corporations. There is much more to modern culture, e.g. alternative and high-quality music released by numerous independent labels, proving the point that consumers are not 'dummies'. This topic generates heated debates as to whether or not cultural industries indeed absorb every single consumer.⁶⁰ Some opined that only an educated minority of consumers could soak up culture: "it is upon a very small minority that the discerning appreciation of art and literature depends; it is... only a few who are capable of unprompted, first-hand judgment".⁶¹ In other words, not everybody can understand the philosophy of Kafka and listen to Shostakovich. Another point of view, *albeit* extreme, that is often suggested is that the consumption patterns are limited to the fact that consumers are 'cultural dupes', or as Marcuse called them, 'one-dimensional men'.⁶² Dwight Macdonald echoes those concerns by noting that:

"Mass culture is imposed from above. It is fabricated by technicians hired by businessmen; its audience are passive consumers, their participation limited to the choice between buying and not buying. The Lords of kitsch, in short, exploit the cultural needs of the masses in order to make a profit and/or to maintain their class rule".⁶³

⁵⁸ The cultural pessimists are represented by Adorno, Horkheimer, Jose Ortega y Gasset, Jacques Ellul, Russel Kirk, Irving Howe, Bernard Rosenberg, Herbert Marcuse and Dwight Macdonald. The speculative estimate affords concluding that the number of cultural pessimists is larger than the number of cultural optimists. For more details see Herbert Marcuse, *One-Dimensional Man* (London: Sphere, 1968), 92.

⁵⁹ Susan Sontag, *Against Interpretation* (New York: Dell, 1966), 26.

⁶⁰ See for example, Cowen, *supra*, n. 57.

⁶¹ Leavis, *supra*, n. 28, at pp. 3, 4.

⁶² Marcuse, *supra*, n. 58.

⁶³ Dwight Macdonald, "A Theory of Mass Culture," in *Cultural Theory and Popular Culture: A Reader*, ed. John Storey (Hemel Hempstead: Prentice Hall, 1998), 23.

The ‘industrialisation of the mind’⁶⁴ does have a huge impact on human consciousness. The way people take and use music is not an uncomplicated process though, to suppose that musical appetites just pander to the machinations of producers is too unsophisticated.⁶⁵ Not all consumers acquire cultural products from supermarkets, top bookselling chains, or the four largest record companies. Storey is a proponent of the fact that consumers are not gullible dummies that are being force-fed by the cultural industries: “culture is not something ready-made which we consume, culture is what we make in the varied practices of consumption”.⁶⁶ Richard Hoggart, whose extract is particularly relevant to this study, supports Storey’s thoughts:

“Songs which do not meet the requirements (of working-class people) are not likely to be taken up, no matter how much Tin Pan Alley plugs them... People do not have to sing or listen to these songs, and many do not, and those who do, often make the songs better than they really are... People often read them in their own way.”⁶⁷

It is possible to agree with the view of F.R. Leavis that although only a minority of people go out of their way to enjoy various cultural activities, one could not make the assumption that there is not a cultivated and intelligent populace. It would be wrong to insist that: “the cultural industries have a Pavlovian hold on their audience and can persuade it to accept any emotion or idea they wish”.⁶⁸ The paradox of cultural industries is that profit-motivated companies produce cultural products,⁶⁹ but it is the consumers who make the ultimate choice on whether or not to buy a particular cultural item:

“To deny the passivity of consumption is not to deny that sometimes consumption is passive; to deny that the consumers of popular culture are cultural dupes is not to deny that the culture industries seek to manipulate. But it is to deny that popular culture is little more than a degraded landscape of commercial and ideological manipulation, imposed from above in order to make profit and secure social control”.⁷⁰

Storey is not the only one who rejects the notion of ‘one-dimensional man’. Angela McRobbie opined that: “the people are too difficult in their diversity, too unpredictable

⁶⁴ Hans Magnus Enzensberger, *The Consciousness Industry* (New York: The Seabury Press, 1974).

⁶⁵ For more details see Alan Swingewood, *The Myth of Mass Culture* (London: Macmillan, 1977).

⁶⁶ John Storey, *Inventing Popular Culture: From Folklore to Globalisation* (Oxford: Blackwell Publishing, 2003), 59.

⁶⁷ Richard Hoggart, *The Use of Literacy* (Harmondsworth: Penguin, 1990), 231.

⁶⁸ Gans, *supra*, n. 57, at p.74.

⁶⁹ Fiske, *supra*, n. 36, at p. 23.

⁷⁰ Storey, *supra*, n. 66, at pp. 52-53.

in their tastes, too likely to stray from the path of class politics,”⁷¹ with Paul Wills reinforcing the view that “people find on the market incentives and possibilities not simply for their own confinement but also for their own development and growth”.⁷²

Thus, it is important to identify the differences between how much power cultural industries have and how much influence they have on consumer behaviour. Despite these differences often being linked, they are not the same. As explained by Fiske:

“The people are not the helpless subjects of an irresistible ideological system, but neither are they free-willed, biologically determined individuals; they are a shifting set of social allegiances formed by social agents within a social terrain that is theirs only by virtue of their constant refusal to cede it to the imperialism of the powerful. Any space won by the weak is hard won and hard kept, but it *is* won and it *is* kept”.⁷³

The mere existence of independent record labels (in contrast to the big four record companies), which predominantly release alternative and eclectic music and have done so for nearly a century, supports the finding that consumers cannot be simplistically branded as cultural dupes. This is particularly so in the age of digital technology and globalisation.

1.5. Globalisation and Glocalisation

Central to this study is the tension between cultural homogeneity and cultural heterogeneity. Whilst Adorno and Horkheimer described the concept of cultural industries based on the situation in the 1940s, modern day scholars⁷⁴ contend that there has been a shift from cultural industries to *global* cultural industries. Particularly within the last three decades, economic forces have evolved into another category, globalisation - a very complex category, which can be defined as “the relentless global flow of capital, commodities, and communications”⁷⁵ across territories. In the view of some authors, globalisation became synonymous with homogenisation of global

⁷¹ Angela McRobbie, “Looking Back at New Times and its Critics,” in *Stuart Hall: Critical Dialogues in Cultural Studies*, ed. David Morley and Chen Kuan-Hsing (London: Routledge, 1996), 252.

⁷² Paul Wills, *Common Culture* (Milton Keynes: Open University Press, 1990), 27.

⁷³ Fiske, *supra*, n. 36, at p. 46.

⁷⁴ Lash and Lury, *supra*, n. 25, at p. 6.

⁷⁵ Storey, *supra*, n. 66, at p.107. For more see Terry Flew, *Understanding Global Media* (New York: Palgrave, 2007).

culture.⁷⁶ Visiting high streets and cities worldwide and finding the same shops and food chains, epitomises this aspect of globalisation. The same situation is witnessed in relation to cultural industries with the most cited offenders being Mickey Mouse and Dallas. The more recent examples include the same formats of entertainment shows that are being adapted to the local tastes of almost every single country, be it Pop Idol, It Takes Two or Strictly Come Dancing. In terms of the record industry, globalisation has generated a situation in which four major record companies control about 75 percent of the market share whilst being responsible for only 20 percent of the new music releases (discussed in greater detail in Chapter 4) with the resulting saturation of the same music products worldwide. Major labels achieve such saturation because there are no barriers for them in a globalised world: they are faceless global companies that move around freely. Rudimentary observation informs that the music that is played on most radio stations across the globe is predominantly of American and English origin. As far as that goes, cultural pessimists could say that F.R. Leavis' forecast of "a standardised civilisation rapidly enveloping the whole world"⁷⁷ has come true. Undisputedly, globalisation had provided cultural industries with a fundamentally different mode of operation and power. Although industrialised, culture in 1945 for Adorno and Horkheimer, was still basically a superstructure; commodification is arguably what they defined as industrialisation.⁷⁸ By contrast, Lash and Lury made the argument that the (cultural) superstructure is diminished due to capitalisation and globalisation and is dissolving into the material base.⁷⁹ To put the argument in another way, culture becomes material once it is in the base.

Having said that, one of the complexities of globalisation can be illustrated by the scenario of differing production modes being subsumed but also allowing and indeed supporting differences by "involving the ebb and flow of both homogenising and heterogenising forces and the meeting and mingling of the local and global in new forms of hybrid cultures".⁸⁰ Other scholars also suggest that cultural globalisation should not be confused with cultural homogenisation⁸¹ and globalisation simply

⁷⁶ Richard Barnet and John Cavanagh, "Homogenization of Global Culture," in *Homogenization of Global Culture. The Case against Global Economy*, ed. Richard Barnet (San Francisco: Sierra Club Books, 1996), 71.

⁷⁷ Leavis, *supra*, n. 28, at p. 30.

⁷⁸ Lash and Lury, *supra*, n. 25, at p. 7.

⁷⁹ *id.*

⁸⁰ Storey, *supra*, n. 66, at p. 112.

⁸¹ Arjun Appadurai, "Disjuncture and Difference in the Global Cultural Economy," in *Global Culture: Nationalism, Globalization and Modernity*, ed. Mike Featherstone (London: Sage, 1994), 307.

signifies a new borderless world. For example, in relation to the record industry, the Internet, in particular, plays a positive role in delivering heterogeneous music to consumers, proving that globalisation is thus not only about global culture homogenisation. Indeed, the positive side of globalisation can be seen in the fact that rare genres of music from other continents can be delivered to consumers within seconds. In this respect, “globalisation offers the possibility of cultural mixing on a scale never known before”⁸² and must be regarded as being positive in its fusing of different cultures. Even such a cultural pessimist as Jean Baudrillard noted that globalisation has not completely won the game when he mentioned that: “heterogeneous forces ... are rising everywhere”.⁸³ Another upside of globalisation is that there is now a resistance, which has been termed as ‘glocalisation’ (the latter signifies the local being championed on a global scale), and this has been the domain of the independent labels. Therefore, in terms of this study, independent music labels represent such heterogeneous forces. The following discourse into the Long Tail continues the analysis of consumption patterns and explains how these small heterogeneous forces contribute to diversity.

1.6. The Long Tail

Chris Anderson was perhaps the first one who pointed out how consumer behaviour has changed since the year of 2000 as a result of the digital revolution. In his seminal book, *The Long Tail*, he stated that the vast majority of products (cultural or otherwise) were not available in stores; interestingly in his view, by necessity “the economics of traditional, hit-driven retail, limit choice”.⁸⁴ It seems that in the record industry there is a gap between what is consumed and what is available, i.e. as stated earlier, 20 percent of the released material by the majors, account for 80 percent of total sales.⁸⁵ To give a concrete example: only 1 percent of music albums are available in high street music retailers, such as Virgin, HMV in the UK or Wal-Mart in the United States.⁸⁶ Of more than 200,000 films produced for commercial release, only 3,000 are available at

⁸² Storey, *supra*, n. 66, at p. 117.

⁸³ Jean Baudrillard, “La Violence du Mondial,” in *Power Inferno*, ed. Jean Baudrillard (Paris: Galilee, 2002), 64.

⁸⁴ Chris Anderson, *The Long Tail: Why the Future of Business Is Selling Less of More* (New York: Hyperion, 2006), 26.

⁸⁵ For the opposite view on the unimportance of the Long Tail see Andrew Keen, *The Cult of the Amateur: How Today's Internet Is Killing Our Culture* (London: Currency, 2007).

⁸⁶ Anderson, *supra*, n. 84, at p. 26.

Blockbuster.⁸⁷ In recent years even big music retailers such as Wal-Mart have been cutting the amount of shelf-space for CDs,⁸⁸ begging the question of where do the rest of the music and films go? The answer lies in the digital on-line world. For comparison, whilst Wal-Mart carries about 4,500 unique CD titles, Amazon lists about 800,000 of them.⁸⁹

Anderson provided a telling example of a digital music service, Rhapsody, with a catalogue of 1.5 million songs.⁹⁰ In contrast, high-street music retailers store about 60,000 songs. The strength of the on-line phenomenon can be illustrated by the fact that each one of Rhapsody's tracks is streamed every month.⁹¹ What is demonstrated is that some people spend their leisure time trying to find the music they want to hear. This phenomenon is called the Long Tail and Anderson professed that "for the record industry it looks like the end of the blockbuster era (the Short Head)":

"You can find *everything* out here in the Long Tail. There's the back catalogue, older albums still fondly remembered by long-time fans or rediscovered by new ones. There are live tracks, B-sides, remixes, even (gasp) covers. There are niches by the thousands, genres within genres within genres ... There are foreign bands, once priced out of reach on a shelf in the import aisle, and obscure bands on even more obscure labels – many of which don't have the distribution clout to get into Tower at all. Oh sure, there is also a lot of crap here in the Long Tail. But then again, there is an awful lot of crap hiding between the radio tracks on hit albums, too".⁹²

For Netflix, Amazon and Rhapsody, between 25–50 percent of sales are generated from products not available from traditional (not on-line) outlets and these products represent the fastest growing area of their businesses.⁹³

"...most of us want more than just hits. Everyone's taste departs from the mainstream somewhere... Unfortunately, in recent decades, such alternatives have been relegated to the fringes by pumped-up marketing vehicles built to order by industries that desperately needed them".⁹⁴

⁸⁷ *id.*

⁸⁸ *The Economist*, "From Major to Minor," January 10, 2008.

⁸⁹ Anderson, *supra*, n. 84, at pp. 20, 90.

⁹⁰ These are the numbers for 2006 when the Long Tail was published.

⁹¹ Anderson, *supra*, n. 84, at p. 22.

⁹² *id.*

⁹³ *id.*, at p. 24.

⁹⁴ *id.*, at p.18.

The Long Tail puts forward the argument that in the largesse of the digital world, all is there and available. However, in an economy that relies on hits, there is paucity⁹⁵ for the world of cultural diversity. These days, neither the existence nor the size of the Long Tail is disputed. However, what are disputed are consumer behaviour and the profitability of the Long Tail. In his research, Chris Anderson provided convincing data. However, the data for 2008 does not present a winning case for the Long Tail.⁹⁶ According to a recent study carried out by the Mechanical Copyright Protection Society - Performing Rights Society (hereinafter, MCPS-PRS), 80 percent of the recordings online sold no copies at all.⁹⁷ To date, there is no unanimous opinion on this matter with some, attempting not to exaggerate the consumers' power in making their choices. Having said that, irrespective of how active consumers are in searching for new cultural products, the existence of the Long Tail proves an abundance of diverse cultural products.

1.7. Cultural Diversity: Definition, Measurement and Its Relation to Concentration

The discussion of cultural industries, globalisation and consumer behaviour would not be complete without highlighting the importance of cultural diversity and how, if at all, it is affected by the high concentration of cultural industries. As the study uses the record industry as a tool to demonstrate that cultural industries deserve special treatment by competition law, this section considers the notion of diversity and why it is important for the record industry and public interest overall.

Perhaps the biggest hurdle to negotiate is the definition of 'diversity', which is an elusive concept, just like the notion of 'culture' itself because both concepts are qualitative. Diversity is indeed difficult to define, let alone measure but it is possible to

⁹⁵ id.

⁹⁶ Helienne Lindvall, "Behind the Music: Is the Long Tail a Myth?" *The Guardian*, January 8, 2009.

⁹⁷ The following researches have challenged Anderson's Long Tail theory: Patrick Foster, "Long Tail Theory Contradicted as Study Reveals 10m Digital Music Tracks Unsold," *The Times*, December 22, 2008; Sean Michaels, "Most Music Didn't Sell a Single Copy in 2008," *The Guardian*, December 23, 2008; Andrew Orlowski, "Chopping the Long Tail Down to Size," *The Register*, November 7, 2008; Jim Milliot, "How Fat is The Long Tail?," *Publishers Weekly*, September 15, 2008. However, Anderson disputed the outcomes of the PRS-MCPS research. See Eliot Van Buskirk, "eMusic Says Data Supports Long Tail Theory," *Wired*, January 15, 2009.

do so if both the definition and measure of diversity are related to market structure.⁹⁸ Various attempts have been made to look at diversity from the cultural industries concentration point of view. Those attempts are examined below.

The issues of culture and diversity have recently received much attention on numerous levels. In 1991, the Treaty of Maastricht incorporated Article 151 (4) into the EC Treaty,⁹⁹ which states the need to protect cultural diversity within the European Community (further examined in greater detail in Chapter 6). On another high level, UNESCO, the most influential organisation dealing with culture and diversity, adopted the Convention on the Protection and Promotion of the Diversity and Cultural Expressions.¹⁰⁰ The Convention re-emphasised the importance of diversity by affirming that cultural diversity is “a defining characteristic of humanity”.¹⁰¹ The Convention defines cultural diversity “... as the manifold ways in which the cultures of groups and societies find expression. These expressions are passed on within and among groups and societies”.¹⁰² Although the UNESCO definition of diversity is rather vague, the Convention claims that cultural products *are* different from other goods and deserve special treatment protecting them from standardised mass consumption.¹⁰³ In other words, cultural diversity represents a variety and an exchange of cultural experiences. As the record industry is used as a case study for cultural industries, for the purposes of this study, diversity means diversity of both products (music) and producers (record companies). This study assumes that producers are not identical, therefore the diversity of producers is intertwined with the diversity of products, and the protection of producers will lead to a broader spectrum of musical diversity.

Since the 1950s economists have proposed that the growth of diversity and innovation was related to the market and its structures.¹⁰⁴ Therefore, within this study which focuses on the record industry and its relationship with competition law, the first logical

⁹⁸ Peter J. Alexander and Brendan M. Cunningham, “Diversity in Broadcast Television: An Empirical Study of Local News in the United States.” *International Journal of Media Management* 6, no. 3&4 (2004): 183.

⁹⁹ The Treaty establishing European Community, 25 March 1957.

¹⁰⁰ See *supra*, n. 35.

¹⁰¹ *id.*, para 1 of the Recital.

¹⁰² *id.*, Article 4.

¹⁰³ To the moment of submission, the United States still has not signed this Convention.

¹⁰⁴ Richard Peterson and David Berger, “Cycles in Symbol Production: The Case of Popular Music.” *American Sociological Review* 40 (1975): 159.

step is to find out whether or not consolidation has affected diversity in the record industry: are levels of concentration connected with levels of diversity?

Before going into a discussion of diversity, a brief explanation of market structures has to be provided. Apart from the competitive or monopolistic markets, there are several other market structures. Out of those, an *oligopolistic market* structure seems to be the most relevant in terms of this study, implying that there are a few firms which release similar but not identical products.¹⁰⁵ Examples of oligopolies include the oil and car manufacturing businesses as well as the record industry. Each firm has sway over what it produces but the products are close substitutes, as are cigarettes, CDs, and computer games. It is believed that these firms have very little intention to innovate, because they have little to gain from investing heavily into risky new products. The consequence is that creativity is being restricted or controlled.¹⁰⁶ Oligopoly theory makes the assumption that small companies are responsible for introducing diversity to the marketplace, as oligopolists would be wary of championing high or even medium-risk products. The voids that are left by oligopolists are filled by smaller enterprises. However, the major drawback of all these theories is that they are based on the economics of competition and they do not take into account producer diversity as well as product diversity. Producer diversity is excluded because competition economics are based on simplistic mathematical models allowing a producer to make only one product. The above explains why competition law does not deal with vague concepts like cultural diversity (discussed below in this section).

Measuring diversity and its relation to highly consolidated industries is an important issue because this study, unlike any others seeking to investigate the problem of diversity and concentration, deals with law. The first attempt to investigate the causal link between market structure and diversity has been made by industrial organisation economists,¹⁰⁷ examining in detail the relationship existing between innovation and

¹⁰⁵ Gunnar Niels, "Collective Dominance: More than just Oligopolistic Interdependence." *European Competition Law Journal* 5 (2001): 168. For a good explanation from the industrial economics point of view see Frederic Scherer, *Industrial Market Structure and Economic Performance* (Chicago: Rand McNally College Publishing Company, 1980).

¹⁰⁶ Paul DiMaggio, "Market Structure, The Creative Process, and Popular Culture: Toward an Organisational Reinterpretation of Mass-Culture Theory." *Journal of Popular Culture* 11, no. 2 (1977): 441.

¹⁰⁷ Industrial organisation is the field of economics that studies the strategic behavior of firms, the structure of markets and their interactions. *A Dictionary of Geography*, 2004, s.v. 'industrial organisation'. The industrial economists were the first ones to approach the market concentration via a division of majors and independents.

diversity levels on the one hand and the size of the firm on the other. Following that, Joseph Schumpeter initiated the academic debate in his work *Capitalism, Socialism and Democracy*, where he argued that because big firms had more wealth, they could afford to develop new products and also that they had the appetite to do so because their market power allowed profits to be made from such innovations.¹⁰⁸ Schumpeter's view seems correct but only in respect to high technology, chemical and oil industries, not cultural industries.¹⁰⁹ Hence, not everybody agreed with the Schumpeterian view,¹¹⁰ with the majority of scholars stressing that it was the small firms who were the real innovators.¹¹¹ Such views are bolstered by the fact that large firms are indeed reluctant to introduce risky products to the market due to both bureaucracy and conservative attitudes and prefer to stick to the model of 'if it isn't broke, don't fix it'. As Chapter 3, which examines the history of competition in the record industry will demonstrate, the above is particularly true with regards to major companies in the record industry with their initial reluctance to release blues, jazz, rhythm & blues, rock & roll and almost any other new genre.

One of the important caveats in terms of this study is that lawyers like to see clear-cut concepts and that is precisely why it was crucially important to find out whether there was a criterion that could measure diversity in the record industry. To date there have been numerous empirical studies testing the relationship between market concentration and product homogeneity in the record industry and other cultural industries. A pervasive problem with the reviewed researches on the relationship of market structure to diversity is that some of them differ in their conclusions, which is somewhat limiting. However, all of them emphasised the *undeniable* impact of oligopolistic market control

¹⁰⁸ Joseph Schumpeter, *Capitalism, Socialism, and Democracy* (New York, Harper, 1942), 59 - 165.

¹⁰⁹ See for example the opinion of Wesley Cohen and Richard Levin, "Empirical Studies of Innovation and Market Structure," in *Handbook of Industrial Organisation*, Volume II, ed. by Richard Schmalensee and Robert Willig (Amsterdam, North-Holland: 1989), 1059.

¹¹⁰ Franklin M. Fisher and Peter Temin, "Returns to Scale in Research and Development: What Does the Schumpeterian Hypothesis Imply?" *Journal of Political Economy* 81 (January/February 1973): 56-70; Kenneth Arrow, "Economic Welfare and the Allocation of Resources for Invention," in *Essays in the Theory of Risk-Bearing*, ed. by Kenneth Arrow (Chicago: Markham Publishing Co., 1971), 145; Frederic Scherer, *Market Structure* (Amsterdam: The New Palgrave, 1987); Edwin Mansfield, "Technological Change and Market Structure: An Empirical Study." *American Economic Review* 73 (1983): 205 - 209 and Edwin Mansfield, *Industrial Research and Technological Innovation* (New York: W.W. Norton, 1968).

¹¹¹ This is discussed in greater detail in Chapter 3. For more information see Charlie Gillett, *The Sound of the City* (New York, Pantheon: 1983); John Ryan, *The Production of Culture in the Music Industry: The ASCAP-BMI Controversy* (Lanham, University Press of America: 1985); Walter Adams and James Brock, *The Bigness Complex* (Stanford: Stanford Economics and Finance, 2004); and Frederic Scherer and David Ross, *Industrial Market Structure and Economic Performance* (Boston, Houghton Mifflin: 1990).

on diversity. Overall, there are three schools of thought about the influence of concentration on diversity. One camp believes that a high level of concentration in the record industry diminishes diversity¹¹² through to the opposite,¹¹³ whilst the minority of scholars are of the opinion that a market structure midway between monopoly and perfect competition is best for promoting innovation.¹¹⁴ Even though all these researches do not provide a clear-cut answer, the predominant outcome is that levels of diversity diminish with higher concentration and the smaller labels fill these ‘diversity’ vacuums.

A pioneering attempt to measure diversity in the record industry and to determine how diversity correlated with the changing levels of concentration in the major record companies was made by Peterson and Berger in the 1970s. They analysed the relationship between diversity and market concentration in the American record industry from 1948-1973 in their seminal paper, *Cycles of Symbol Production*.¹¹⁵ The work assumed that innovation and diversity were indeed products of competition.¹¹⁶ Concentration levels were measured using two tests: one on the then top four and one on the then top eight major record companies; diversity was measured as the top 10 *hits* during 52 weeks. Peterson and Berger found evidence for the inverse relationship between concentration and diversity, i.e. higher concentration equalled less diversity. According to their research, 80 percent of the songs examined fitted into “a

¹¹² Michael Black and Douglas Greer, “Concentration and Non-price Competition in the Recording Industry.” *Review of Industrial Organisation* 3 (1986): 13 – 37; Bruce Owen and Michael Spence, “Television Programming, Monopolistic Competition, and Welfare.” *The Quarterly Journal of Economics* 91, no. 1 (1977): 103 – 126; Shu-Fang Lin and Daniel McDonald, “The Effect of New Networks on U.S. Television Diversity.” *The Journal of Media Economics* 17, no. 2 (2004): 105 – 121; Ben Bagdikian, *The Media Monopoly* (Boston: Beacon Press, 1997); Barry Litman, “The Television Networks, Competition, and Programme Diversity.” *Journal of Broadcasting* 23 (1979): 393 – 409; Hyuhn-Suhck Bae, “Product Differentiation in Cable Programming: The Case in the Cable National All-News Networks.” *Journal of Media Economics* 12 (1999): 265 – 277; and Ryan, id.

¹¹³ Paul Lopes, “Innovation and Diversity in the Popular Music Industry, 1969 – 1990.” *American Sociological Review* 57 (1992): 56 – 71; and Robert Burnett, “The Implications of Ownership Changes on Concentration and Diversity in the Programme Industry.” *Communication Research* 19 (1992): 749 – 769.

¹¹⁴ The outcome depends on the parameter and the industry used. For example, Berry and Waldfogel found evidence that the increased concentration of radio stations reduced the entry barriers without reducing the diversity. See Steven Berry and Joel Waldfogel, “Do Mergers Increase Product Variety? Evidence from Radio Broadcasting.” *The Quarterly Journal of Economics* (August 2001): 1009 – 1025. Such finding could be contrasted with the research into the connection between diversity and consolidation in broadcast television carried out by Alexander and Cunningham. They found that diversity of local news content was sensitive to the level of concentration. See Alexander and Cunningham, *supra*, n. 98, at p. 183.

¹¹⁵ Peterson and Berger, *supra*, n. 104, at p. 159.

¹¹⁶ Peterson and Berger also suggest that there is a clear distinction between innovation and diversity. See Richard Peterson and David Berger, “Measuring Industry Concentration, Diversity, and Innovation in Popular Music.” *American Sociological Review* 61, no. 1 (1996): 176. However, for the purposes of this research, diversity and innovation bear the same meaning.

conventionalised cycle where sexual references are allegorical and social problems are unknown and cover records were a significant part of the charts”.¹¹⁷ Peterson and Berger’s research has generated a lot of discussion with many authors having subsequently used the same methodology in their research. However, their result is not conclusive because their figures for 1964 to 1969 show increased concentration *as well as* increased level of diversity. The fact that Peterson and Berger were unable to consistently show an inverse relationship between diversity and concentration was documented in their later papers.¹¹⁸

Following the above, similar research was carried out to cover the period between 1974-1980.¹¹⁹ Rothenbuhler and Dimmick used Peterson and Berger’s method to test whether the record industry was exhibiting the same patterns of the oligopolistic market conditions of the 1948-1955 period, characterised by high concentration and low diversity. Their data also showed a pattern of increasing concentration accompanied by a decline in diversity. However, using Peterson and Berger’s method, Burnett¹²⁰ has found that *no* inverse relationship existed between concentration and diversity. Also, interestingly revealed was the view that majors and independents were cooperating, for instance in the case of mutually advantageous licensing and distribution deals. Burnett also argued that majors’ acquisition of independent labels increased general diversity. Other scholars like Lopes and Ross¹²¹ supported Burnett’s findings, underlining the fact that high concentration was not necessarily damaging to diversity because it was often the case that larger companies would embrace the innovations of smaller companies and as a consequence, increase overall diversity. Therefore, it was argued that even though record industry concentration was high, diversity levels were high too.¹²²

¹¹⁷ Peterson and Berger, *supra*, n. 104, at p.163.

¹¹⁸ Richard Peterson, “Cultural Studies through the Production Perspective,” in *The Sociology of Culture*, ed. by Diana Crane (Oxford: Blackwell, 1994), 189 and *supra*, n. 117, at p. 178.

¹¹⁹ Eric Rothenbuhler and John Dimmik, “Popular Music: Concentration and Diversity in the Industry, 1974-1980.” *Journal of Communications* 32 (1982): 143; Eric Rothenbuhler and John Dimmik, “The Theory of the Niche: Quantifying Competition among Media Industries.” *Journal of Communication* 34, no. 4 (1984): 103.

¹²⁰ Robert Burnett, *The Global Jukebox: The International Music Industry* (London: Routledge, 1996); Robert Burnett, “Concentration and Diversity in the International Phonogram Industry” (PhD diss., University of Gothenburg, 1990).

¹²¹ Lopes, *supra*, n. 113, at p. 56 and Peter Ross, “The Emergence, Development, and Mainstreaming of British Punk Rock Music.” *Popular Music and Society* 20 (1996): 133 – 161. For more on the competition and cooperation issue see Jonathan Gander and Alison Rieple, “Inter-organisational Relationships in the Worldwide Popular Recorded Music Industry.” *Creativity and Innovation Management* 11, no. 4 (2002): 248 – 254.

¹²² Section 4.2 will demonstrate that such conclusion has a limitation.

However, Peterson and Berger's methodology was not favoured by everyone and has been described as 'flawed',¹²³ 'limited',¹²⁴ and 'unreliable'¹²⁵ because their method measured diversity by reference to lyrics without even touching upon other aspects of a song, e.g. melody and genre. Another obvious drawback is that they only used the Billboard hit parade data, whilst ignoring the total supply of recorded music. As Lopes suggested, examining a correlation between concentration and diversity by defining who owns the charting material is flawed and inadequate.¹²⁶ The most commercially successful pieces of music are not particularly indicative of existing diversity and such a narrow view ignores that fact.¹²⁷ A more realistic enquiry should be discussed in terms of the musical diversity of records released especially, in a Long Tail world, e.g. different genres, styles, approaches, and innovative ideas.¹²⁸

A more precise method to investigate the connection between consolidation and diversity in the record industry, applied by Christianen, included the database of all the albums released in a particular territory.¹²⁹ The rationale for using the debut albums released in one year was to examine the gate-keeping function of major record companies. New artists have greater market access when there is a scenario of low concentration. However, during periods of high concentration, fewer artists get any exposure. Christianen found that independents existed in the void that majors created and that the relationship between diversity and concentration was inverse.

Peter Alexander employed another interesting method using the application of entropy theory.¹³⁰ The upshot of his research showed that both low and high levels of market

¹²³ David Hesmondhalgh, *The Cultural Industries* (London: Sage, 2002), 233.

¹²⁴ The quantity is not synonymous with quality, but quality is a better indicator of cultural diversity. See Jeffrey Mondak, "Cultural Heterogeneity in Capitalist Society: In Defence of the Repetition on the Billboard Hot 100." *Popular Music and Society* 13 (1989): 55.

¹²⁵ The method used by Peterson and Berger, Burnett and Lopes is unreliable because it only used the Billboard hit parade data, whilst ignoring the total supply of recorded music. See Michael Christianen, "Cycles in Symbol Production? A New Model to Explain Concentration, Diversity and Innovation in the Music Industry." *Popular Music* 14, no. 1 (1995): 56.

¹²⁶ Peterson and Berger noted themselves in their recent commentary that "concentration ratios were accurate measures of musical product *ownership*, but...they are no longer good measures of the *concentration of creative control*". Peterson and Berger, *supra*, n. 116, at p. 175.

¹²⁷ Mondak, *supra*, n. 124, at p. 55.

¹²⁸ For example, Dowd measured musical diversity based on melodic, rhythmic, and choral elements. Timothy J. Dowd, "Musical Diversity and the U.S. Mainstream Recording Market, 1955-1990," (English version of "Diversificazione Musicale e Mercato Discografico negli Stati Uniti, 1955-1990," *Rassegna Italiana di Sociologia* XLI (2): 223-263 (2000)), 3.

¹²⁹ Christianen, *supra*, n. 125, at p. 59.

¹³⁰ Entropy is a value used in mathematics to quantify information. Peter J. Alexander, "Entropy and Popular Culture: Product Diversity in the Popular Music Recording Industry." *American Sociological Review* 61 (2004): 171.

concentration led to decreased product diversity, whilst maximum diversity resulted from a *moderately* concentrated market structure.¹³¹ This method is similar to the one used by Peterson and Berger but the measure of diversity was amongst the top 40 hits during 1948 to 1988. In this analysis, it was not the number of hits that counted, rather it was the combination of several measures: form, accent, harmonic structure, and melody. However, the lyrics were not analysed. The results showed that during the early years of ‘rock revolution’ (around 1955 to 1966), major hit recordings were relatively homogenous when compared to those of the years 1967 to 1977, i.e. when concentration in the industry was higher. This contradicts the conclusion of Peterson and Berger. However, for the period of 1971 to 1988, diversity decreased whilst concentration increased, thus implying that the relationship between concentration and diversity was non-linear and that product diversity was maximised when the industry was moderately concentrated.

The above findings mean that a new approach to measure cultural diversity in the film industry is of particular interest. Moreau and Peltier carried out research into film diversity between 1900 and 2000.¹³² The main result of their comprehensive research was that *supplied* diversity and *consumed* diversity were positively correlated, and the former was always higher than the latter. Moreau and Peltier’s method included three determining factors of cultural diversity: variety, balance and disparity and the more these factors existed the greater the diversity. They suggested that in the case of the film industry, these three dimensions of diversity could be presented as: the film, the genre, and the geographical origin. With respect to the first dimension, each film was considered unique. According to the second dimension, the genre, diversity increased in direct proportion to the number of genres available (comedies, dramas, cartoons etc), the extent to which they were equally represented and the extent to which the genres were clearly differentiated from each other. The third dimension was self-explanatory: film diversity increased in direct proportion to the number of different geographical origins available.

Moreau and Peltier presented an interesting interaction: the smaller the difference between *supplied* and *consumed* diversity the higher the degree of diversity and *vice*

¹³¹ id.

¹³² Francois Moreau and Stephanie Peltier, “Cultural Diversity in the Movie Industry: A Cross-National Study.” *The Journal of Media Economics* 17, no. 2 (2004).

versa. Their research demonstrated that the film industry was threatened by the concentration of consumption on a small number of films and by low diversity actually on the screens. In their conclusion Moreau and Peltier observed that it was *demand* that adapted to the *supply* and not the other way round. Thus supply, can to a certain extent, influence what consumers demand.

Following this method, diversity in the record industry could be measured using the dimensions appropriate for the record industry: the song, the genre, (hip hop, dance, punk etc.) and the geographical origin. Such a research method appears worthwhile as it could take into account the amount of the albums *released* on both major and independent labels and the amount of albums actually *sold*. Unfortunately, it would be impossible to obtain the required complete data for such research (similarly, to the above research regarding the film industry) and such study is beyond the scope of this thesis.

In addition to the above, other ways for measuring diversity have been presented. An interesting suggestion was made by Ross that in the digital age, examining the whole idea of innovation is more advantageous outside of the majors.¹³³ An alternative way to measure diversity could be to measure producer diversity by analysing the number of existing or new labels coming to the market every year; whilst product diversity could be measured by the number of songs released by majors and independents as well as the number of songs purchased.¹³⁴

Even though the above studies had different research methods and conclusions, their significance lies in showing a correlation between high cultural industry concentration and lower levels of diversity. The connection between diversity and high levels of concentration should not be underestimated and necessitated considering the impact of competition law upon such matters. Even though Adorno's approach to cultural industries was not entirely objective and could be described as elitist,¹³⁵ he rightly connected standardisation with the high concentration of cultural industries, mostly in private hands (for more see Chapter 4). Furthermore, he was not the only one to stress the link between consolidation and diversity. Douglas Kellner too outlined a strong link

¹³³ Ross, *supra*, n. 121, at p. 484.

¹³⁴ Perhaps the difficulty in obtaining statistics explains why the previous researchers mostly concentrated on hit records only.

¹³⁵ This could be inferred from his highly negative attitude towards jazz music.

between capitalism and culture with the former representing the interests of “corporate domination and profitability”.¹³⁶

As mentioned earlier, the record industry is not alone in facing the problem of high concentration leading to less diversity.¹³⁷ Other types of cultural industries experience similar problems, and concerns have been consequently raised. For example, Bagdikian pointed out the disastrous consequences of having little competition in the American media sector.¹³⁸ He quotes the instance of how mass advertising left only one paper standing in 1981 in Washington.¹³⁹ He also highlighted a direct link between diversity of opinions and concentration in the media industry.¹⁴⁰ His standpoint is supported by the fact that in competitive markets, newspapers contain more serious news and gain circulation more readily. In the words of Leo Bogart: “with the best of intentions in the world, it is difficult for a monopoly daily to avoid complacency and establishmentism”.¹⁴¹ Newspapers generally try to avoid overt and extreme political affiliations, as they need to attract the widest possible readership thus making them an attractive proposition to advertisers.¹⁴²

Laura Miller has raised similar concerns in her investigation of major and independent booksellers¹⁴³ (the treatment by competition law of cultural diversity in the book industry is discussed in Chapter 6). She noted that book sellers in the US too have gone through several waves of mergers and acquisitions, with the latest one being in the mid 1990s which led to a large number of independents being forced out of business, including some of the US’ most well-known stores.

¹³⁶ Douglas Kellner, *Critical Theory, Marxism and Modernity* (Baltimore: Johns Hopkins University Press, 1989), 182.

¹³⁷ See for example, Herbert I. Schiller, *Culture, Inc.: The Corporate Takeover of Public Expression* (New York: Oxford University Press, 1989) and John R. Meyer *et al*, *The Economics of Competition in the Telecommunications Industry* (Cambridge, Massachusetts: Oelgeschlager, Gunn & Hain, 1980), 160.

¹³⁸ Bagdikian, *supra*, n. 112.

¹³⁹ *id.*, at p. 123.

¹⁴⁰ A new view has recently emerged, which insists that newspapers should be allowed to consolidate in the twenty-first century in order to survive because they are losing advertising income to Google and Yahoo. See *BBC*, “Warning of Death of Journalism,” April 17, 2009.

¹⁴¹ Also cited in Bagdikian, *supra*, 112, at p. 129.

¹⁴² *id.*

¹⁴³ Laura Miller, *Reluctant Capitalists: Bookselling and the Culture of Consumption* (Chicago: The University of Chicago Press, 2006).

For example, in 1991, independent booksellers' adult book sales were responsible for 32.5 percent of books sold whilst big chains were responsible for only 22 percent.¹⁴⁴ The situation had changed in 1997; the independent's share had dropped to 17 percent whilst the chains' share had grown to 25 percent.¹⁴⁵ At that point, nearly half of the market was dominated by two chains: in 1997, Barnes & Noble and the Borders Group accounted for 43.3 percent of bookstore sales.¹⁴⁶

The above research exemplifies the prevalent opinion that cultural diversity is important for public interest and benefit. It also shows that consolidation of cultural industries leads to a diminishing level of diversity. However, despite the fact that the importance of *cultural industries* is highlighted in numerous government speeches and documents, little has been said or done about the protection of *diversity*. It should not be forgotten that in the 1984 the US opted out of UNESCO and it took 17 years to re-join the organisation. The UK likewise opted out and re-joined UNESCO in 1997. Moreover, after reviewing the relevant legislation, it seems that cultural diversity is not a stated aim of the existing laws at all. There is no mention of the requirement of cultural diversity in the UK and US copyright and competition legislation. One of the reasons may be that cultural diversity is indeed a loose concept whilst lawmakers require clearly defined economic concepts. However, as previously demonstrated, cultural diversity *can* be measured. Another reason for the omission may lay in the fact that governments may not necessarily wish to promote cultural *diversity* (even though they constantly emphasise the importance of cultural industries) since, for example, the more money the record industry makes, the more money flows into the economy and the surest way to make a profit, is to sell what sells best and fast, i.e. homogenised cultural products. The paradox of the situation is that competition law affects cultural industries, but it does not take cultural issues into account when multi-national mergers and acquisitions in the cultural sector take place. This issue is illustrated in a number of case law arguments discussed in Chapters 5 and 6 and is important to bear in mind for the conclusion of this study.

¹⁴⁴ *id.*, at p. 52.

¹⁴⁵ *id.*

¹⁴⁶ *id.* Explained by the fact that big chains depend on a steady flow of fast-selling bestsellers. It is in a way a vicious circle because major publishing houses therefore produce the kinds of books they think the big chains will be able to sell.

This discourse into the diversity of cultural products is not putting forward the idea that standardised products are the only ones that capitalism requires. Of course, capitalism requires diversity, but it has to be a *controlled* diversity, “a diversity that is determined and limited by the needs of its mode and production”.¹⁴⁷ Copying products that have already been popular in the market place is an obvious strategy employed by many. In this respect, Meade rightly outlined the dichotomy that exists between the requirement for product diversity and the advantageous economics of manufacturing a limited variety of products. Such a situation is explained by the high substitutability and high overhead costs being the main factors in market economy.¹⁴⁸ Thus in today’s cultural industries, economy of scale is a determining factor, but it can contradict the interests of the consumers who want diverse products.¹⁴⁹

The next section considers the need for regulation of cultural industries and explains why competition law should be considered as an important tool in regulating cultural industries.

1.8. Regulation of Cultural Industries: Competition Law, De-regulation and Self-Regulation

In late 1970s Williams proclaimed that the same attention given to industrial institutions should be enjoyed by cultural industries, which had hitherto been under researched.¹⁵⁰ A decade later Girard insisted for the inclusion of cultural industries in cultural policy-making: “policy-makers persistently ignored the place that industrial cultural products were gradually taking in people’s leisure time...”¹⁵¹ He commented further that:

“...today, not only is a debate on the subject [regulation of cultural industries] inevitable, it is highly desirable and should be carried out at all levels... New trends of thought are required to articulate cultural policies with cultural industries...”¹⁵²

¹⁴⁷ Fiske, *supra*, n. 36, at p. 29.

¹⁴⁸ James Meade, “The Optimal Balance Between Economies of Scale and Variety of Products: An Illustrative Model.” *Economica* (November 1974), 367.

¹⁴⁹ Dixit and Stiglitz arrived to a similar conclusion. Avinash Dixit and Joseph Stiglitz, “Monopolistic Competition and Optimum Product Diversity.” *American Economic Review* 67, no. 3 (1977): 297 – 308.

¹⁵⁰ Raymond Williams, *Marxism and Literature* (Oxford: Oxford University Press, 1977), 136. Also cited in Garnham, *supra*, n. 19, at p. 123.

¹⁵¹ Augustin Girard, “A Commentary: Policy and the Arts: The Forgotten Cultural Industries.” *Journal of Cultural Economics*, 5, no. 1 (1981); 62.

¹⁵² *id.*

Having said that, regulation is controversial. It becomes more problematic when cultural industries are at issue because contestation over the regulation of culture includes struggles over meanings and interpretations. The latter represents the main argument of the opponents of the special treatment of culture. Indeed, can regulation of cultural industries develop unless it is based on data and facts? Is culture too vague for the rules of law? Can regulation of cultural industries be dynamic enough to produce a *status quo*? These are all legitimate concerns, and this thesis addresses them.

One type of regulation is of particular interest, i.e. the regulation of anti-competitive behaviour in the record industry, which in turn is intertwined with high levels of concentration. Hence the research contained in the thesis critically analyses how competition law could and should be used to protect cultural diversity. The main issue is whether or not cultural elements could be taken on board when regulating competitive dynamics and anti-competitive behaviour of highly concentrated corporations. Therefore, this section looks into the need of cultural industries regulation by competition law. For comparison, de-regulation and self-regulation of cultural industries are also briefly examined.

Competition law is an economics-based law and is aimed at balancing the competitive dynamics in different markets as well as maximising the production of goods at competitive prices. The economic character of competition law can be seen in Article 2 of the Maastricht Treaty, which states that the ultimate objectives of the EU are: “a harmonious, balanced development of economic activities, ... and a high degree of competitiveness and convergence of economic performance”.¹⁵³

Price theory economics are of dominant importance in competition law. All the analyses, be they of mergers or acquisitions between oil industries or cultural industries are carried out in terms of whether a proposed merger or acquisition is bound to produce a price increase and/or price-fixing. Unlike the concentration in the aviation or automobile industries, concentration in the record industry is worth separate attention because the issues raised are not of pure economic nature.¹⁵⁴ As indicated above, on the one hand, the record industry is responsible for providing employment and economy

¹⁵³ The Treaty of Maastricht on European Union, February 7, 1992.

¹⁵⁴ See more in Peristera Kremmyda, “Comment,” in *The Evolution of European Competition Law: Whose Regulation, Which Competition?*, ed. Hanns Ullrich (Cheltenham: Edward Elgar, 2006), 191.

growth, but on the other hand, it has a cultural function, which makes “the concentration of ownership in this sector a problem different in nature and in importance from that encountered in other sectors of the economy”.¹⁵⁵ This research argues that price increase, whilst being an appropriate yardstick for typical industrial firms, is of little relevance to the interests of cultural industries. In contrast, the *non-price* issues, such as obtaining radio play and shelf-space are of crucial importance for the record industry, and ultimately its consumers.

In the words of ex-Commissioner, Mario Monti: “if competitors are eliminated from a market not because of competition on the merits but through anti-competitive practices, this is to the clear detriment of consumers and innovation”.¹⁵⁶ Thus, in the present globalised and oligopolistic world particularly, both the competition policy and the authorities should serve economies *as well as* public interests. Interestingly, Mario Monti described competition law as “an interdisciplinary combination of at least, law, economics, and politics, which at times disconcertingly reveals the stamp of history, philosophy and perhaps geography when least expected”.¹⁵⁷ The latter statement is of particular interest as this research will show how unpredictable, political and uncertain the application and interpretation of legal rules can be.

Too often throughout the history of competition law it was political reasons that determined the outcome of a ruling. In fact in the US, the fundamentals for competition law were political rather than economical,¹⁵⁸ e.g. the US civil war (1865) led to the vast industrialisation and growing power of oil and coal trusts.¹⁵⁹ However, because of public demand and in the public interest, the competition law, namely the Sherman Act (1890), projected “a hatred of monopoly”¹⁶⁰ and declared the trusts “a growing and intolerable evil”.¹⁶¹ Therefore, when necessary competition law can ‘invent’ the tool to protect public interests. It is interesting to note how the financial crisis of 2008

¹⁵⁵ *id.*

¹⁵⁶ Commissioner Mario Monti, “Competition for Consumers’ Benefit,” *Competition Day*. Amsterdam. October 22, 2004, at p. 2.

¹⁵⁷ *id.*, at p. 6.

¹⁵⁸ Clifford Jones, “Foundations of Competition Policy in the EU and USA: Conflict, Convergence and Beyond,” in *The Evolution of European Competition Law: Whose Regulation, Which Competition?*, ed. Hanns Ullrich (Cheltenham: Edward Elgar, 2006), 22.

¹⁵⁹ *id.* For more details see Clifford Jones, *Private Enforcement of Antitrust Law in the EU, UK, and USA* (Oxford: Oxford Press, 1999), 6 – 8.

¹⁶⁰ *id.*

¹⁶¹ *id.*

demonstrated that both the Commission¹⁶² and the national governments¹⁶³ had the power to act quickly and interfere when public interest¹⁶⁴ (and the economy) needed to be protected. But for some reasons modern competition policy-makers are resistant to embrace cultural diversity and non-price elements in their analyses. Indeed it seems that both the American and European competition policy-makers have used political considerations to protect the interests of the merged parties, and not so much the public.¹⁶⁵

The opinion of scholars provided in previous sections shows a consensus that cultural diversity represents a legitimate value¹⁶⁶ that needs to be protected for the public interest. The protection of cultural diversity becomes even more important in the light of the significant growth and consolidation of cultural industries since the 1980s. Mergers and acquisitions have become “an expression of globalisation”.¹⁶⁷ This process triggered a long debate about the positive and negative effects of corporate mergers in the cultural sector. Whilst high concentration is quite common for some industries, e.g. oil and commodities’ industries,¹⁶⁸ for the reasons described in this chapter, cultural industries represent a particular concern. According to some scholars, the Commission regulated cultural industries’ mergers as well as possible, in particular,

¹⁶² For example, the Commission speedily produced a new set of rules with regard to state aid in the face of the economic crisis. See Edward Fennell, “Credit Crisis: European Commission’s Dazzling Moves Keep Business on Track,” *The Times*, December 4, 2004.

¹⁶³ For example, the waiver of merger policy for the merger between Lloyds TSB and HBOS in 2008, when the Secretary of State in the UK sealed the merger despite concerns by the OFT as to the potential lessening of competition in the banking area. This merger was branded a ‘policy mistake’. See John Vickers, “The Financial Crisis and Competition Policy: Some Economics.” *Global Competition Policy* (2008): 2, 8. See also Charles Whiddington, “Competition Law in Hard Times.” *Field Fisher Waterhouse* (2008): 1-3.

¹⁶⁴ In the words of John Vickers: “Not until October 24 did financial stability become a public interest consideration in the UK merger law”. Vickers, *supra*, n. 163, at p. 4.

¹⁶⁵ This can be illustrated by the acrimonious dispute between the Federal Trade Commission in the US and the European Commission as to the merger between Boeing and McDonnell – Douglas. Whilst the former body allowed the merger, the latter did not. See *Boeing Company/McDonnell – Douglas Corporation* 5CCH Trade Reg. Rep. (CCH) (Transfer Binder 1997 – 2001) & 24, 295 (July 1, 1997) and Case IV/M.877 - *Boeing/McDonnell – Douglas* [1997] OJ L 336/16. Back then, politicians of all levels from Al Gore to Bill Clinton became engaged in the matter, with the former threatening trade sanctions for the EU if the Commission did not approve the merger. For a good account of the events see Clifford Jones, *supra*, n. 158, at p. 35.

¹⁶⁶ The sufficient importance of culture to merit special treatment was also emphasised by DiMaggio, *supra*, n. 26, at pp. 65-66.

¹⁶⁷ Ruth Soetendorp and Martin Kretschmer, “EMI, Time Warner and European Competition Policy.” *Intellectual Property Forum* 43 (Dec 2000): 56.

¹⁶⁸ *id.*, 57.

the media mergers.¹⁶⁹ This study shows that the Commission could have done a better job when regulating mergers and acquisitions in the record industry.

Up to the moment of writing, the record industry is dominated by the oligopoly of four major record companies. As the history of competition and growth of the record industry will demonstrate in Chapter 3, within the past two decades, concentration of the record industry has escalated, with four major record companies (Universal, Sony, Warner and EMI) controlling about 75 percent of the global music market, whilst responsible for only about 20 percent of music releases.¹⁷⁰ Such growth was not organic, but largely achieved by mergers and acquisitions, which not only help majors amass the necessary financial capital, but also changes the structure of the industry. Having said that, the majors' market share alone is not such a big concern in itself. What is important however is that market share equals market power, which is often used by the majors to exercise anti-competitive behaviour in the market place (analysed in greater detail in Chapter 4).

Historically, it was the majors' parent electronic or media companies, such as Sony, Thorn, Vivendi, and BMG that have wholly or partly owned them. Mainly these corporations are massive and diversified media conglomerates with music accounting for only a small percentage of their overall revenue. In many cases, these transnational corporations use music as a loss leader to sell consumer electronics.¹⁷¹ Therefore, majors epitomise complete vertical integration from the signing of artists and recording them to the marketing and distribution of their music. This power, in turn, makes major record companies the gate-keepers, controlling both market access as well as the music that consumers are exposed to. By also controlling the life source of the industry, copyrights, the larger proportion of distribution channels are consequently controlled.¹⁷² Majors should be seen in contrast to small, medium, and large-sized independent music labels (indies), which tend to specialise in niche or alternative music. Altogether, independent labels have about 25 percent of the market. Chapter 3 will demonstrate

¹⁶⁹ See Laurence Idot, "Mergers in the Media Sector: Business as Usual?" in *The Evolution of European Competition Law: Whose Regulation, Which Competition?*, ed. Hanns Ullrich (Cheltenham: Edward Elgar, 2006), 190.

¹⁷⁰ Patrick Burkart, "Loose Integration in the Popular Music Industry." *Popular Music & Society* 28, no. 4 (2005).

¹⁷¹ For more on synergies see Paul du Gay *et al.*, *Doing Cultural Studies: The Story of the Sony Walkman* (London: Sage, 1997), 1 – 121.

¹⁷² Peter Alexander, "Entry Barriers, Release Behaviour, and Multi-Product Firms in the Music Recording Industry." *Review of Industrial Organisation* 9 (1994): 92 - 93.

that it is the independents that are predominantly responsible for cultural diversity as they historically introduce the majority of genres into the music market.

Logically, it seems strange that EU competition law to date has no clear-cut jurisdiction and competence for regulating cultural industries. The law only contains a number of provisions, which in theory should be enough to prevent high concentration and certain types of anti-competitive behaviour, e.g. merger regulation and Article 81 of the EC Treaty (discussed in Chapters 5 and 6 correspondingly). However, concerns have already been raised in terms of the failure of competition law to prevent high consolidation of cultural industries.¹⁷³ Perhaps this is why there were demands that the special status of media industries should be accommodated under the EU Merger regulations.¹⁷⁴ Interestingly, back in 1970s the European Court of Justice (hereinafter, the ECJ) already recognised that cultural industries do have a specific and separate role and ruled that broadcasting was a cultural industry as well as a cultural activity.¹⁷⁵

Not every scholar agrees that competition law in itself can be an adequate tool to cater for questions of cultural diversity.¹⁷⁶ Regulation of cultural industries by competition law can be contrasted with two other trends, i.e. de-regulation and self-regulation. The former category was extremely popular with media industries in the 1990s.¹⁷⁷ In this respect, the media industry faced similar problems to the record industry, i.e. the dichotomy between pluralism (requiring ownership control and restraint) and media industry development (de-regulation).¹⁷⁸ Pluralism was protected in the name of public interest but governments were also forced to negotiate with large companies for more media deregulation.¹⁷⁹ Lobbying powers then were so powerful, that pluralism did indeed suffer with economic performance within the media industries being the justification. Therefore, the conflict between *economic* prosperity and *diversity* is relevant to other types of cultural industries. From this example it can be seen that de-

¹⁷³ Alison J. Harcourt, "EU Media Ownership Regulation: Conflict over the Definition of Alternatives," *Journal of Common Market Studies* 36, no. 3 (1998): 373.

¹⁷⁴ These calls have become silent due to an internal conflict in the Commission over definition of the issue. *id.*, at p. 375.

¹⁷⁵ *id.*, at p. 374. See also Case 155/73 - *Saachi* [1974] ECR 409.

¹⁷⁶ See for example, Kremmyda, *supra*, n.154, at p. 191.

¹⁷⁷ For example, in France it was the relaxations on concentrations of ownership in the television and radio sectors in 1994. See Council of Europe, "Report on Media Concentrations and Pluralism in Europe." MM-CM (January 1997): 40 – 41. In the UK it was the Broadcasting Act, which de-regulated restrictions on broadcasting and cross-media ownership. See Broadcasting Act, 1996, Chapter 55.

¹⁷⁸ Gillian Doyle, "Regulation of Media Ownership and Pluralism in Europe: Can the European Union Take Us Forward?" *Cardozo Arts & Entertainment Law Review* 16 (1998): 453.

¹⁷⁹ *id.*, at p. 455.

regulation of the media industry has not provided the desired outcome in terms of pluralism. The Commission's involvement in safeguarding pluralism has been questioned as media concentrations have been understandably fairly unrestrained by governments.¹⁸⁰ Unfortunately, back then in the 1990s the Commission noted that the intervention could be justified "...*only* on the basis of securing the proper functioning of the internal market and *not* on the basis of protection of pluralism, *per se*".¹⁸¹ Therefore, the Commission shut its eyes to the reality of mergers; although not necessarily impairing competition, they may well challenge diversity of opinion.¹⁸² This argument is extremely relevant to mergers in the record industry.

As mentioned earlier, another popular trend in cultural industries is self-regulation.¹⁸³ An attempt of self-regulation with respect to competition in the record industry, *albeit* ill-fated, was the recent decision by the Association of Independent Music (hereinafter, AIM) and International Music Publishers and Labels (hereinafter, Impala), trade bodies for independent labels in the UK and EU correspondingly, *not* to oppose a Warner takeover of EMI, two of the biggest record companies in the world.¹⁸⁴ In February 2007, after the Sony/BMG merger defeat at the CFI (the Sony/BMG merger is critically analysed in Chapter 5 and the Conclusion), Warner struck a secret deal with Impala *not* to oppose the then rumoured merger between EMI and Warner. In return, Warner promised to provide the multi-million dollar funding for the newly established independent music labels' licensing agency Merlin.¹⁸⁵ This in itself could be unproblematic, however the main issue was that some of the Board members of AIM happened to also be Board members of Impala, who in turn were the Interim Board members of Merlin. The support of AIM for Impala's back-up of the Warner and EMI merger, came at a price as not everybody agreed with such a state of affairs. Two of AIM's members resigned claiming that the merger would be anti-competitive and that AIM had not disclosed a personal interest in the matter. Those two members being Gut Records¹⁸⁶ and the biggest dance music label in the world, Ministry of Sound.¹⁸⁷

¹⁸⁰ Lesley Hitchens, "Media Ownership and Control: A European Approach." *Modern Law Review* 57 (1994): 585.

¹⁸¹ Commission of the European Communities, "Pluralism and Media Concentration in the Internal Market: An Assessment of the Need for Community Action." COM (1992): 480 final, 99. Also cited in Doyle, *supra*, n. 178, at p. 465

¹⁸² Doyle, *id.*

¹⁸³ Thompson, *supra*, n. 30, at p. 4.

¹⁸⁴ Andrew Orlowski, "Indies at War over Music Mega Merger," *The Register*, February 26, 2007.

¹⁸⁵ AIM, "Merlin Appoints Interim Board." April 16, 2007.

¹⁸⁶ Lars Brandle, "AIM Preps Emergency Meeting after Gut Splits," *The Billboard*, February 26, 2007.

"It [the Warner/EMI merger] makes our lives more difficult in the retail sector, it makes getting racking in store more difficult, it makes getting attention in media more difficult, because these large companies leverage their power to get support for their artists."¹⁸⁸

This spat generated a highly acrimonious public exchange of legal letters and threats as well as huge media interest.¹⁸⁹ It is obvious that Impala has placed itself in a very difficult position, especially so because it backed the proposed Warner/EMI merger only 6 months after its victory in the CFI, which annulled the Sony/BMG merger.

The above does show how difficult and ineffective both de-regulation and self-regulation of the cultural industries can be. Therefore, this study will argue that competition law still has a crucial role to play in regulating cultural industries in the twenty-first century, *albeit not* in its existing form, because asking record companies to regulate themselves is rather like asking Dracula to look after a blood bank. Hence this study will concentrate on the importance of *legal* regulation of cultural industries, and where regulation is found wanting.

In terms of competition, the fact that larger scale entities absorb smaller scale entities is not a new phenomenon.¹⁹⁰ However, in terms of cultural industries, the importance of smaller scale entities lies in the fact that they are responsible for diverse cultural products. To date, very little research has been undertaken in order to show the effect that competition law has had on cultural industries. This study represents a brand new look at cultural diversity from the competition law angle and *vice versa*. Moreover, the legal regulation of anti-competitive behaviour in the record industry is a mainly unexplored area. There is a gap in the academic debates and practice that this thesis seeks to mend by thorough examination of mergers and acquisitions in the record industry.

¹⁸⁷ Jonathan Richards, "Ministry of Sound's Walkout Presents New Hurdle for EMI Warner Deal," *The Times*, February 24, 2007; Ian Watson, "Shocked MOS Quits AIM over Impala," *The Billboard*, February 23, 2007.

¹⁸⁸ Quoting Lohan Presencer, MD of Ministry of Sound. Also cited in Watson, *id.*

¹⁸⁹ *AIM*, "AIM Responds to Ministry of Sound's Legal Threats." March 5, 2007; and Orłowski, *supra*, n. 184.

¹⁹⁰ Appadurai, *supra*, n. 81, at p. 295.

1.9. The Importance of Small Business in Cultural Industries

Finally, a concluding remark should be made about an important category that runs throughout this study - small businesses in cultural industries. In their work, Adorno and Horkheimer strongly emphasised that from the twentieth century cultural industries were subservient to organised capital:

“Under monopoly capital all mass culture is identical.... The people at the top are no longer interested in concealing monopoly: as its violence becomes more open, so its power grows”.¹⁹¹

Despite the fact that standardisation is a mainstay of capitalism there is also the need for diversity and new products to generate increasing turnover.¹⁹² The big players are not *the only* players in cultural industries. Cultural pessimists have not considered in greater detail the opportunities that existed in cultural industries, e.g. the ‘vacuums’ that were filled by smaller companies. Often small firms do not just flesh out vacuums but are instrumental in producing what is best in modern culture. It seems true that high market concentration in any industry means greater standardisation. However, speaking of the record industry, there always existed a symbiosis of major record companies and small labels with the latter discovering the majority of new talent and genres, and the former capturing the markets of genres that had been tested and proved popular by independents.¹⁹³

The discussion in this chapter on the state of modern culture affords concluding that despite the general pessimism, it is not doomed. Even Adorno’s thoughts leave some hope. He did find fault lines in the previously smooth homogeneous veneer of societies under late capitalism, i.e. he did find enlightenment.¹⁹⁴ F.R. Leavis, also a cultural pessimist, likewise concluded that “mass-production and standardisation have not

¹⁹¹ Theodor W. Adorno and Max Horkheimer, “The Culture Industry: Enlightenment as Mass Deception,” in *The Cultural Studies Reader*, ed. Simon During (Routledge: London, 1999), 32.

¹⁹² Stratton, *supra*, n. 9, at p. 150.

¹⁹³ For example, in Netherlands the supply of music per genre during 1975 - 1992 showed that independents were active in 23 genres such as Jazz, Gospel and Folk, whereas majors were active in just five genres such as Pop and Soundtracks. The detailed data on the contribution to diversity by the independent record labels is provided in Christianen, *supra*, n. 125, at p. 69. See also the opinion of Toll: “The innovators did things that were not generally accepted, and sometimes consciously challenged popular tastes and trends” in Robert Toll, *The Entertainment Machine: American Show Business in the Twentieth Century* (Oxford: Oxford University Press, 1982), 106; and Matilda Egere-Cooper, “How the UK’s Urban Music Underground is Establishing a Unique Identity,” *The Independent*, February 3, 2006.

¹⁹⁴ Max Horkheimer and Theodor W. Adorno, *Dialectic of Enlightenment* (New York: Continuum, 1976). See also Cook, *supra*, n. 22, p. xiv.

achieved their supreme triumph yet”¹⁹⁵ and there is “the vague hope that recovery must come, somehow, in spite of all.”¹⁹⁶ Indeed constant creativity provides hope. As has been shown above, not all consumers are manipulated by corporations. There are certain consumers who spend their time looking for unknown, eclectic, and non-mainstream music. Chapter 3 will illustrate that it is predominantly small music labels that release these types of music.

Cultural pessimists also rightly highlighted the commodification of music from the twentieth century. However, they neglected the important “cottage industry” aspects of production and work organisation within small independent labels that have always played a vital role in the cultural sphere.¹⁹⁷ Therefore, it can be argued that independent music labels *de-commodify* and *democratise* both music and the record industry because they retain pre-industrial features of cultural production. This study will demonstrate that independent labels are the force that at least seeks to limit the market power of the major record companies. Small labels are the most likely groups to passionately care about diverse music and its availability as well as provide a robust argument against commodification, as opposed to those working to produce good results for shareholders and stock exchanges.¹⁹⁸ Their specialised knowledge affords them a legitimacy that majors do not have. It would be a mistake to state that all independent music labels are altruistic, but they certainly “run on a less single-mindedly profit-oriented system”,¹⁹⁹ which in turn allows them to be a lot more diverse than the four labels controlling the recorded music market. New digital technology is instrumental in fostering the proliferation of independent labels, which in turn increases the diversity of music heard:

“[With independents] we can hear a greater diversity of expression than is allowed through the gates of big record companies – with their narrow ideas about what kind of music is profitable. For instance, if you knew hip-hop only from what you heard on the radio or MTV, you’d rightly come to the conclusion that it’s about nothing but bitches and money”.²⁰⁰

¹⁹⁵ Leavis, *supra*, n. 28, at p. 30.

¹⁹⁶ *id.*, at p. 31.

¹⁹⁷ Garnham, *supra*, n. 19, at p. 139.

¹⁹⁸ Schiller, *supra*, n. 137, at p. 42.

¹⁹⁹ Stratton, *supra*, n. 9, at p. 150.

²⁰⁰ Quoting Mr Lif, artist with the Def Jux label. Also cited in Kembrew McLeod, “MP3s are Killing Home Taping: The Rise of Internet Distribution and Its Challenge to the Major Label Music Monopoly.” *Popular Music and Society* 28, no. 4 (2005): 527.

Stratton rightly highlighted that when small companies grow in size they adopt the structure of a big company, and profit becomes more important. However, Chapter 3 will discuss the fact that only a tiny percentage of independents grow in size. By contrast, no major record company grew in size naturally. They grew in size due to numerous mergers and acquisitions. Even though very few independents can be considered as big in size, there is still a chasm between the smallest major and the biggest independent label,²⁰¹ with the latter nevertheless being a lot more diverse than majors. Even a strong critic of romantic ideology like Stratton admitted that small labels are “pressured to preserve the rationale that they record good music. Were it not for this rationale, there would be no reason for their existence...”²⁰² Thus, these labels can be considered as the force that prevents the total industrialisation of the record industry, and in this study it is argued that the independent music labels, a small but influential force in the record industry, provide the opportunity to listen to diverse music.

Section 1.3. demonstrated the connection between culture and economics. Independent labels are no exception to that connection but they can be said to keep culture at the superstructure level, not letting it collapse into the base. From the standpoint of this thesis, they are a source of enlightenment. However, further chapters will demonstrate that independents, whilst still being niche players, seek to play a more influential and active role in the digital age record business.

1.10. Limitation of the Study

Although this study investigates the relationship between competition law and cultural industries, it has used the record industry as a vehicle to demonstrate that competition law has failed in preventing high concentration within cultural industries and that the latter deserved special treatment by competition law. It would have been ideal to carry out similar investigations into other types of cultural industries, but it was not possible due to the word and time constraints. To make up for that lack of coverage, a number of examples from other types of cultural industries have been provided in Chapters 1 and 6.

²⁰¹ Martin Mills, “SonyBMG Annulment Good for Business.” *The Billboard*, September 8, 2006.

²⁰² Stratton, *supra*, n. 9, at p. 153.

Chapter 2: Methodology

2.1. Description and Rationale

This chapter outlines the methods employed in researching whether or not cultural industries deserve special treatment by competition law and to what extent competition law has managed to protect cultural diversity so far. The following sections present the study's research strategy and theoretical framework.

There are a number of rationales for studying the relationship between the law and cultural industries. Even though some research has been undertaken in relation to the nature and history of the record industry and its levels of diversity²⁰³ (see Chapters 1 and 3), most scholars' attention concentrated on organisational structures rather than any competitive dynamics in the record industry.²⁰⁴ This thesis seeks to fill the aforementioned gap by means of a mixed model, combining legal study, historical study and interviews, using a triangulation method in order to prove and thereby support the conclusions made.

2.2. Statement of the Problem

The chapter explains the method and research strategy for the following research question: whether or not the independent record sector as a cultural industry deserves special treatment under competition law and if so, how has competition law in the past protected cultural diversity, and consequently how could the law be changed in order to protect cultural diversity more effectively in the cultural industries, with specific focus on the independent record industry?

In order to deal with the research question, the work was divided into three sections:

²⁰³ Laurence Shore, "The Crossroads of Business and Music: A Study of the Music Industry in the US and Internationally" (PhD diss., Stanford University, 1983); Timothy Dowd, "Making the Mainstream Market: Organizational and Musical Change in the US Recording Industry" (PhD diss., Princeton University, 1996); Burnett (1990), *supra*, n. 120.

²⁰⁴ David Hesmondhalgh, "Independent Record Companies and Democratisation in the Popular Music Industry" (PhD diss., Goldsmiths College, 1996).

1. Does the independent record sector as a cultural industry deserve special protection through competition law? After carrying out the research, the answer to this question was positive and the importance of cultural industries, as well as the independent record industry, has been explained in greater depth in Chapter 1.
2. As this study answered the previous question positively, therefore the secondary question was then considered, i.e. whether or not competition law had managed to protect cultural diversity so far. The answer to this question was negative; this is dealt with in Chapters 5 and 6, which analyse both merger regulation and merger cases in the record industry as well as Article 81 of the EC Treaty.
3. After concluding the previous point, the next question to be answered was how competition law could be amended so that it would be more effective in protecting cultural industries in the future. The answer to this question is provided in the Conclusion.

This particular chapter is organised as follows. Firstly, the definitions are provided so as to inform the reader of the key concepts. Secondly, the definitions are followed by a detailed explanation of the research strategy and methods involved in this research, namely that of legal study, historical study and interviews.

2.3. Definitions of the Main Concepts

In this thesis the *record industry* is used as a case study for *cultural industries*. Of course, there are other types of cultural industries, such as those involved with literature, films, art and media but the sole focus of this work is on the record industry. The record industry is defined as four major record companies (Universal, Sony, Warner and EMI – together the “majors”) having approximately 75 percent of the market share, the remainder belonging to independent music labels (“independents”). In this research, it is argued that independents are largely responsible for the diversity of music (for more on the importance of independent labels in terms of cultural diversity see sections Chapter 3).

For the purposes of this thesis, *cultural diversity*, as has been defined in Chapter 1, is the diversity of producers and diversity of products, i.e. the diversity of record labels and music itself.²⁰⁵ In this thesis, it is argued that the former is intertwined with the latter.

Also in this thesis, *competition law* includes both EU merger regulation and Article 81 of the EC Treaty. The USA merger test is also considered for comparative analysis.

In addition to the legislation, the research considered a number of cases with particular emphasis on the Sony/BMG merger case. The case demonstrated that competition law has no specific legal rules, which can be applied in order to regulate competition in cultural industries. Furthermore, the Conclusion provides ideas on how existing competition law could be improved to incorporate the consideration of culture and cultural diversity, specifically in those cultural industries, with which it directly relates.

2.4. Research Strategy & Theoretical Framework

In order to answer the research question of this study, a mixed model of data collection was used, as this is an accepted method of data collection for qualitative research.²⁰⁶ The three main types of data collection comprised legal study, historical study and qualitative interviews. Having provided three parts of the research question in Section 2.2, and before explaining each method, it is appropriate to demonstrate how my methods helped answer those questions.

In order to answer the first part of the research question, multiple methods have been employed. Firstly, the notion of cultural industries had to be unpacked. This was achieved by the literature review. Secondly, to explore what the independent record industry sector is, both historical analysis and interviews have been carried out. The history of the record industry has demonstrated that from almost its inception, small labels were the real innovators and risk-takers, which did increase overall musical diversity when concentration levels were low. The interviews highlighted the unique

²⁰⁵ For the justification of this approach see Christianen, *supra*, n. 125, at p. 55.

²⁰⁶ Catherine Marshall and Gretchen B. Rossman, *Designing Qualitative Research* (London: Sage, 2006), 97 – 120; and Lisa Webley, “Qualitative Approaches to Empirical Legal Research.” In press: H.Kritzer & P. Cane, *The Oxford Handbook to Empirical Legal Studies*, Chapter 31.

characteristics of independent labels and emphasised their role in risk-taking. Thirdly, examining whether competition law could provide a particular treatment of cultural industries necessitated using legal analysis as well as the interviews. The former was necessary to understand what the law says at the moment and the problems that need to be rectified. The legal analysis also demonstrated how both the merger and acquisitions cases in the record industry were dealt with by competition law. However, legal analysis alone would not have been sufficient. In order to find out about the issues that are not covered by competition law, interviews with industry leaders were carried out to explore their perceptions, which in turn gave me an insight to the background of the problems with the record industry's high concentration that was not obvious purely from a legal analysis.

Answering the second part of the research question, namely whether or not competition law managed to protect cultural diversity, necessitated utilising mainly legal analysis of the case law and the legislation. Once again, the legal analysis provided an understanding of the law as it stood. However, an analysis of competition law could not have given all the answers. Therefore, a historical analysis was also needed to look into cultural diversity (in this case the diversity of music under different levels of concentration in the record industry).

In order to answer the third part of the research question, as to how competition law could be amended so that it would be more effective in protecting cultural industries, legal analysis was employed to understand the limitations and benefits of competition law treating cultural industries in a special and particular way.

As shown above, all three methods were used to complement each other.

A quantitative questionnaire could have been used as an alternative method of gathering data. However, my concern was that I would not have had enough responses to be able to analyse the data quantitatively, and therefore would not have met the requirements for quantitative research. Quantitative research would have probably provided me with more breadth, but qualitative research has provided me with more depth and focus. For example, one of the research methods described below, the interviews, allowed an open-ended discussion that in turn provided me with an insight into an individual's

experience. Arguably, the quantitative method would have given me a narrower context within which to work.

2.4.1. Legal Study

As competition law and policy constitute a crucial part of the thesis, it was necessary to consult legal sources related to competition law and the record industry including primary data²⁰⁷ such as case law and relevant legislation. The main case law cited in this thesis related to the merger of Sony and BMG, which included the approval of the merger by the Competition Commission in 2004, the disapproval of the merger by the Court of First Instance in 2006, and the re-approval of the merger by the Competition Commission in 2007.

Other relevant legal sources included such secondary sources as commentaries on the law that explained its background as well as legal academic commentaries. A majority of the information regarding competition law in this thesis was obtained from various publications, such as authoritative legal journals, books and official press releases from the European Competition Commission, the Court of First Instance and the Federal Trade Commission. In addition to these publications, very valuable and innovative information was found in a range of authoritative legal on-line sources, which have been specified, where relevant, and which include sources such as the Social Science Research Networks.

As outlined above, competition law for the purposes of this thesis was the European competition merger regulation (hereinafter, the ECMR), case law and a comparative analysis of the US merger test and case law. Apart from merger regulation, for the sake of completeness, Article 81 of the EC Treaty was also considered. In terms of merger regulation, the analysis of the “old EU merger test”, relating to the “*strengthening of a dominant position*”,²⁰⁸ was necessary because it allowed me to appraise to what extent the “new EU merger test”, relating to whether there is “*significant impediment of*

²⁰⁷ In terms of the interpretation of the law.

²⁰⁸ Article 2(2) of Council Regulation (EEC) No 4064/89 of December 21, 1989 on the Control of Concentrations between Undertakings (OJ 1989, L395) as amended by Council Regulation (EC) No 1310/97 of June 30, 1997 (OJ 1997, L 180).

effective competition”,²⁰⁹ could accommodate cultural diversity. Moreover, the analysis of the new EU merger test (although not yet implemented in any merger cases in the record industry) was necessary in order to see whether it could potentially address some of the issues in relation to competition in the record industry, e.g. non-price or non-economics matters.

In this respect, it was interesting to compare how other jurisdictions dealt with the problem of high consolidation in the record industry and this study focused on the USA as a comparative model. The conclusion is that the US merger test, “*substantial lessening of competition*” (hereinafter, the SLC test),²¹⁰ although being an economics-based test, is better suited to deal with the competition issues in the record industry because it is less stringent. However, because a huge amount of lobbying power and politics were involved in the Sony/BMG merger, the US merger test also failed to stop the major record companies from consolidating even further.

Investigating the merger regulation alone would have not provided the complete picture of the competition law. Therefore, Article 81 of the EC Treaty, [which deals with situations] “*rendering incompatible with common market all agreements between undertakings which may affect trade between Member States*”, was also analysed even though it is yet to be applied to the record industry. In this case, the record industry was replaced by another type of cultural industry, i.e. the book industry, which allowed me to draw some conclusions by analogy.

Thus, within the legal analysis, four separate tests were carried out:

- 1) Analysis of the old EU merger test, which included primary legislation and case law, as well as secondary commentary on the legislation and case law.
- 2) Analysis of the new EU merger test, which likewise included primary legislation, as well as secondary commentary on the legislation. This merger test is yet to be implemented in relation to the record industry but some forecasts were made in this paper as to its possible application.

²⁰⁹ Article 2 (2) of Council Regulation (EEC) No 139/2004 of January 20, 2004 on the Control of Concentrations between Undertakings (OJ 2004, L 24).

²¹⁰ Section 7 of the Clayton Act, 15 U.S.C. § 18.

- 3) Analysis of the US merger test, which included primary legislation and case law, as well as secondary commentary on the legislation and case law.
- 4) Analysis of Article 81 of the EC Treaty, which included primary legislation and case law (predominantly in relation to the book industry as Article 81 is yet to be applied in terms of cultural diversity in the record industry), as well as secondary commentary on the legislation and case law.

In terms of the legal study, there have been a number of both practical and conceptual problems encountered. One of the biggest problems with this research was that it coincided with the ongoing Sony/BMG merger dispute, which resulted in a great deal of uncertainty for me as a researcher working under a time constraint. In 2004 the Commission approved the merger (the Sony/BMG merger is analysed in Chapter 5). In 2006 the Court of First Instance annulled the merger, whilst the second investigation by the Commission re-approved the merger in 2007. The Commission issued the final approval on the 3 October 2007 but it was not published until the 18 June 2008. This too caused a delay with finalising the arguments. In each decision the competition authorities suggested new developments and approaches which I critically analysed and changed my conclusions correspondingly after each ruling was published. There was also a positive element to this dispute – each new ruling, be it the one by the Commission or the Court of First Instance, added more arguments in favour of the special treatment of culture by competition law.

A conceptual problem I faced was my not being an American lawyer, as part of the research required me to spend a fair amount of time understanding the nuances of the American competition system, i.e. what factors they take into account when reasoning their decisions, and learning what some of the American legal concepts meant, e.g. the rule of reason. Having said that, both practical and conceptual difficulties have been overcome in presenting this research and the conclusions it provides.

2.4.2. Historical Study

Historical research was the second method utilised in this study. Whilst there are several good sources written about record industry history,²¹¹ the point of this study was to focus on different stages of record industry consolidation (such as primary and secondary consolidations) and to examine what factors had been driving large record companies towards consolidation.

The historical analysis is based predominantly on secondary sources, because the commentators of different eras have encapsulated growth and diversity patterns at different stages of the record industry's evolution. These diverse authoritative sources also allowed me to construct timelines of concomitant stages of consolidation and competition in the record industry, and analyse how those stages correlated with musical diversity levels at those times. The timeline, in turn, provided a complementary analysis of the connection between concentration and diversity levels discussed in Chapter 1. The study also examines how such high levels of consolidation affected small labels as well as cultural diversity and what role independent labels played in that process, e.g. record industry democratisation and de-commodification in discovering and releasing new and non-mainstream music. Such approaches were necessary in terms of data analysis, e.g. looking at the developments between majors and independents and the patterns of consolidation at different periods, plus the impact of consolidation on diversity.

The historical study has covered the evolution of the record industry from the moment the phonograph was invented by Thomas Edison in 1877. The description of the background of the record industry has been compiled in such a way as to demonstrate its cyclical nature and the patterns of the majors' responses to crisis situations, which in turn neatly tie up with the reasons for merging, discussed in Chapter 4.

Thus the methodology necessitated seeking out pieces of information from available authoritative secondary sources such as books, academic articles and other studies relevant to the research question. A process of linking them together was undertaken in a manner that not only explained the past but also aided an understanding of the present.

²¹¹ See for example Pekka Gronow and Ilpo Saunio, *An International History of the Recording Industry* (London: Cassell, 1998).

These items amassed the collective knowledge of particular fields within the record industry in considerable detail and thus became a valuable resource in supplementing the primary data gathered during fieldwork.

2.4.3. Qualitative Interviews

As mentioned above, qualitative interviews are an accepted way of collecting data for qualitative research and therefore were used in preparing this study.²¹² The interviews carried out were a small but important part of this research. They provided an additional examination of certain tentative conceptual ideas that had emerged from the documentary analysis stages of the research. Overall, the interviews could be described as intensive individual interviews to prove or disprove some of my hypotheses, as well as a way to develop a convincing argument independent of statistical testing.

It should be noted that most of the written sources concerning major record companies and independent labels are either historical reports about their creation or about charismatic personalities involved in their management.²¹³ There are a few sources, however, which contain a good description of the economics and structure of the record industry and the majors in particular.²¹⁴ Since very little was written scientifically about the way majors and independents operated, particularly reflecting on their competitive dynamics and the changing patterns in the digital age, interviews with record label executives and other music industry figures helped me gather this information. The qualitative interviews were aimed at obtaining the opinions of the experts in the field based on the shifting notion of independents in the digital age and how, in their opinion, competition law affected cultural diversity and the use of copyright. The interviews were also utilised in order to provide some ideas as to whether or not the record industry's high concentration was of concern to independent labels and what effect the recent mergers had on the independent sector. These matters are covered in greater detail in Chapter 4, dealing with mergers and acquisitions.

²¹² Kjell Rudestam and Rae Newton, *Surviving Your Dissertation: A Comprehensive Guide to Content and Process* (Newbury Park, CA: Sage, 2001), 97-98, and Alan Bryman, *Social Research Methods* (Oxford: OUP, 2004), 318 – 335.

²¹³ Frederic Dannen, *Hitmen* (New York : First Vintage, 1991).

²¹⁴ Keith Negus, *supra*, n. 56; Marc Huygens *et al.*, “Co-evolution of Firm Capabilities and Industry Competition: Investigating the Music Industry 1877 – 1997.” *Organisation Studies* 22, no. 6 (2001), 981.

As there are no statistics on how many independents there are in the UK and the USA or in any country for that matter, I came up with two different classifications of independent labels: one based on the size of labels in terms of their profits and market power and the second based on their business model and motivation. The ten interviews (the participants are discussed below in this section) carried out are considered to be broadly illustrative of a range of (i) different size classifications (some interviewees were the owners / founders of very small labels, whilst others ran extremely successful independent labels), (ii) different business models (some of the interviewees were passionate about keeping their independence whilst others were prepared to co-operate with majors) and, (iii) different motivations (different reasons for setting up independent labels by the interviewees).

Since it was impossible to interview the entire population of independent labels, a form of stratified sampling was used instead, i.e. the key characteristics were chosen for each group. Those key characteristics were utilised as a method to identify and select interviewees. In keeping with the qualitative method employed in this research the selection was broadly representative of the key characteristics. However, it was not representative in any statistically valid sense of the word.

a) The Sequence of the Process

The research started in October 2004. The interviews were left to the last stage of this research because I wanted to carry out both legal and historical studies first in order to enable a more sophisticated interview process. Two interviews were carried out in 2006 because I wanted to find out at the time how the industry compiled its statistics, and why certain labels opted for the Creative Commons instead of the copyright institution. The rest of the interviews were carried out between June and October 2007.

All interviews apart from one were conducted in London; the exception having been an interview conducted in Los Angeles. Each interview varied between 45 minutes to 1 hour, the longest interview lasting for 1 hour 20 minutes. All the interviews were recorded to a minidisc (on file with the author) and then transcribed.

b) Process & Instrumentation

Firstly, it is important to acknowledge my connections within the record industry. During 2005-07, I worked for the music industry business network, MusicTank, as a researcher and events coordinator for numerous conferences and think tanks. In addition to that, since the middle of 2007 I have been an artist manager. These experiences gave me an appreciation of the industry's dynamics, how both big labels and small labels operated, and their business practices. Those credentials gave me the status of participant observant that on the one hand helped me come up with key issues for the interviews and on the other hand made access to the interviewees a lot easier. My status afforded an approach to some of the interviewees, whereas my peers helped me obtain an interview with other participants.

It is important to acknowledge that my status allowed me to ask knowledgeable questions but it did not prevent me from critiquing and analysing the responses of the interviewees. It must be stressed that I had no shares in any of the companies nor did I or do I, have any financial interest in any enterprises. The latter enabled me to keep my independence as an external observant. Due to my status I was able to observe certain practices: how artists are restrained by their record contracts, organisational and cultural differences between major and small record companies, the ever-increasing role of the marketing departments at the major record companies and the lack of record contract transparency. In doing so, the ethics of participant observation have been preserved. As a participant observer I developed empathic neutrality,²¹⁵ i.e. whilst I had empathy with what the interviewees were saying, I at all times remained neutral towards the findings. My objectivity was uncompromised as I remained critical and reflective about the findings throughout.

There are a number of limitations that arise when employing participant observation. Positivists could argue that there are issues with the validity and reliability of the data, arguing that the findings depend on a particular researcher's interpretation. That indeed could present a weakness to the research but, as specified above, I sought to test my findings and impressions against other data to provide rigorous triangulation. It is also important to note that because I was a participant observant in the record industry,

²¹⁵ Michael Patton, *Qualitative Research and Evaluation Method* (London: Sage, 1996), 50.

generalising the findings in terms of other cultural industries, addressed in both Section 1.10 and the Conclusion would be problematic.

My status also provided me with knowledge of the key characteristics of independent labels thus helping me to analytically design the interview questions. The questionnaire was a structured qualitative data collection instrument. It helped collect important information about the key issues that run throughout the thesis. The questionnaire was constructed in a way to firstly help understand what an independent label is, and secondly, whether the classic notion of an independent label caring only for the artists and music diversity has changed in the digital age. The characteristics of independent labels had to be lined up against those of major record companies to examine if there are any fundamental differences between them that could impact upon musical diversity. The questions were structured to cover the key characteristics of record company behaviour, for example, the way copyrights were handled, a company's size, different business models and motivation were all investigated. Secondly the questionnaire considered the competition issue. It was interesting to find out whether independent labels had been worried at all about the industry's high concentration and what were the main obstacles for independents in the digital age, if any. The interviews were finished with an open question about record industry regulation.

The interviewees were selected on the basis of meeting key characteristics and access; they did not receive questions in advance. However, the interviews could be described as semi-structured, because where necessary there was room for additional questions depending on how the interviews progressed, e.g. sometimes it was necessary to play 'devil's advocate' when enquiring about the more controversial issues such as the 'selling out' of a label (i.e. sale by an independent label to a major label). Sometimes questions had to be varied and inconsistencies taken into consideration and clarified.²¹⁶

c) Participants

The list of the interviewees included celebrated figures that covered the widest range of record industry experience. These 10 interviewees captured the gamut from artists (3 participants) to label executives (7 participants) and managers (2 participants) to a

²¹⁶ A technique recommended achieving a better outcome from the interviews. Bryman, *supra*, n. 212, at p.332.

copyright expert (1 participant), and a Creative Commons specialist (1 participant), with the majority of the interviewees being crossovers combining 2 roles. The numbers are simply here to illustrate that the interviewees were selected based on the key characteristics and roles of the record industry (copyright, Creative Commons, artists, labels etc). More importantly, almost all of them have worked for major and independent labels, thus providing invaluable comparative knowledge about both.

All the participants were chosen because of their expertise within the field. Even though the objective of my research was to remain open to discovery, it is important to note that interviewees were purposefully selected due to their knowledge and expertise as my intention was to interview people who were relevant to the research question.²¹⁷

As mentioned above, my status of participant observer allowed me to choose a diverse sample group. For example, to cover the varied range of the music labels and their (financial) interests, this thesis took into consideration not only copyright law but also the relatively novel Creative Commons scheme. On another level, it is a common practice for the most successful independent labels to sell their businesses to major record companies (reviewed in depth in Section 3.4). However, the majority of independent labels do not do so, either because they are not successful enough to be of any interest to the majors, or for ideological reasons. In this respect the interview with the Fading Ways Records' founder, Neil Leyton, was very valuable because it provided a counter-balance to the sell-out stories. The sample group is also unique because it represented different degrees of independent labels, resulting in different challenges and different opinions on high concentration within the record industry. For example, the hugely successful Dramatico Records, who has Katie Melua on its roster, has different issues with high concentration, than for example, the small jazz label, Dune Records. However, interestingly, some of the answers were the same throughout many interviews, irrespective of a particular label's size and level of success.

For the purposes of this research the following interviews were carried out:

1. **Keith Jopling** (06 February 2006) – then Chief Analyst of the International Federation of the Phonographic Industries.

²¹⁷ Purposive sampling is a recommended technique for qualitative researches. *ib.*, 333-4, and Rudestam, and Rae, *supra*, n. 212, at p. 93.

2. **Neil Leyton** (20 March 2006) – an artist, founder and owner of Fading Ways Records, a label using Creative Commons as opposed to copyright and specialising in the release of non-commercial music.
3. **Mike Batt** (09 July 2007) – composer, conductor, producer, founder and owner of Dramatico Records (Katie Melua), Deputy Chairman of the British Phonographic Industry (hereinafter, the BPI).
4. **Geoff Travis** (20 June 2007) – founder and owner of the Rough Trade Shop and Rough Trade Records.
5. **Safta Jaffery** (21 June 2007) – artist and producer manager, ex-owner of Taste Media (discovered and developed Muse on his independent label), sold-out to Warner in 2005.
6. **Adjei Amaning** (26 June 2007) – owner of Vanquish Records, a small independent rock label.
7. **Darrell Panethiere** (27 June 2007) – international copyright consultant, ex-Head of the Copyright Department in the US Congress, ex-legal advisor to IFPI and Warner.
8. **Keith Harris** (6 September 2007) – Stevie Wonder's manager outside of the US, Director of the Artist Affairs at the Public Performance Limited (hereinafter, the PPL).
9. **Bobby Colomby** (26 September 2007) – producer and drummer with Blood, Sweat & Tears.
10. **Janine Irons** (25 October 2007) – the CEO of Dune Records, a small independent label specialising in jazz releases by black artists.

A few caveats regarding the notion of independent labels are worthy of mention because they could have presented a problem in answering the research question. The first caveat was that independent labels are mainly small businesses and many of them want to grow to the size of the next major label. A second caveat was that the main aspects of independence become immediately redundant when a major offers money to buy out the label. The third important caveat was that particularly in the digital age, independent labels are certainly in the business of profit making as much as the majors. Thus, it was necessary to question the cultural importance of independent labels and their financial interests, as this contradiction represented one of the main problems in terms of why competition law should have protected the small business in cultural industries, because the latter too, could have been considered as competitors to the big

businesses that have sought to increase their financial gain. All these issues are examined in far greater detail in Chapters 3 and 4. Of course, there is a limitation to the findings because not all independent labels are pure independents (this is further discussed in Section 3.2.2), but there are labels to which none of those caveats are applicable, and therefore looking at cultural diversity from the independent labels' point of view was appropriate. Just as there is a limit on the reliability of the statistical data, there is a limit on how diverse some of the independents are, but as shown in this research, independents are undeniably more diverse than the four majors.

A number of other issues should be mentioned at this point. The record industry is a small cottage industry in terms of people who work in it, and despite gaining easy access to some of these people due to my insider status, many respondents asked for confidentiality when quoting controversial statements. Thus, wherever it was felt during the writing up of this work that a particular statement could be considered controversial, confidentiality was granted for that particular quote. In all other cases, the names of the interviewees are provided.

It was decided to stop at 10 interviews since it was felt that theoretical saturation was reached essentially because some of the interviewees were providing very similar answers. Besides, the status of the record industry figures interviewed meant that they were extremely knowledgeable about the characteristics I wanted to cover in this research and they provided very informative answers.²¹⁸ The interview group should be seen in contrast to the millions of people who only have a MySpace page and who could have given me longer interviews; but it is doubtful whether they would provide as informative and reliable data as the sample selected for this thesis. Obviously, it would have been possible to talk to more people, but as this methodology has demonstrated, I was not relying on the interviews as the only data source. It was decided not to interview the CEOs of majors because due to their positions they would not be able to answer certain tricky questions about the reasons for merging and the exploitation of copyrights etc. More to the point, as mentioned above, with one exception, all the interviewees have worked for both majors and independents either as lawyers, managers, A&R managers or artists, thus they could speak reliably about both types of entities. I only used those sources of methodology that were needed for this research. It

²¹⁸ Short interviews by their nature of not necessarily being in-depth are often insightful. Bryman, *ib.*, at p. 331.

is important to re-emphasise that I was looking at the sector as a participant observer and so would only approach those who were inside rather than outside (but influential) of the industry. Hence competition lawyers have been excluded from the interviews. Had I been involved in another research area, e.g. how competition lawyers view the record industry, obviously it would be necessary to interview competition lawyers, but this was not the case. Additionally, there has been an abundance of both primary and secondary competition law sources.

At the end of the interview stage, data analysis was carried out for which *thematic coding*²¹⁹ was chosen in preference to other methods of interview analysis because having read the relevant literature, I knew the key issues that were markers for cultural diversity, e.g. concentration and copyright. After the interview stage was over, the interviewees' responses were re-analysed and coded by pulling out the relevant parts, which related to each characteristic and those responses were used for the data analysis. After the data was analysed, the relevant chapters were re-written incorporating the data obtained during the interviews. For example, one of the sections in this thesis, covering the differences between major record companies and independents, is based primarily (but not solely) on the data obtained from the interviews. This was done on purpose to avoid the previous academic views about the idealistic nature of the independents. Chapter 4, which covers the relationship between copyright and competition law and Chapter 5 covering mergers and acquisitions in the record industry, are based primarily on the detailed analysis of the numerous relevant commentaries and case law, combined with the data obtained from the interviewees.

Thus, in terms of collecting data, all three types of methods perfectly fitted together and complemented each other. The crucial point is that these methods answered the research question. It should be noted that the research was carried out in cycles because the nature of it necessitated going from one method to the other.

²¹⁹ The essence of thematic coding is classification (in this study, the qualification included the cultural diversity, concentration, copyright etc), therefore allowing easy retrieval of text relating to a particular issue. For more on thematic coding see Richard E. Boyatzis, *Transforming Qualitative Information: Thematic Analysis and Code Development* (London: Sage, 1998).

2.5. Data Analysis

In order to answer the research question a *triangulation method* was utilised to corroborate evidence, an acceptable method in qualitative research.²²⁰ The method ensured that the same question was looked at from different viewpoints, coupled with continuous cross checking of the data.²²¹

2.5.1. Legal Study

In order to answer the two elements of the research question, it was necessary to explain how far competition law has managed to protect cultural diversity. In this particular case, a four-stranded approach was utilised.

Firstly, the primary data sources in relation to the EU old merger test were considered.

Secondly, the conclusion was supplemented with the discussion of commentary by leading academics on the operation of the old EU merger test and the way it was applied to the merger and acquisition cases in the record industry. This allowed me to conclude as to the extent to which the old test protected competition and cultural diversity in the record industry. A similar mode was employed in relation to the new EU merger test and the extent of its possible protection of competition and cultural diversity.

Thirdly, since many record labels span the USA, and the latter has a different merger test, it was necessary to consider the extent of protection of competition and cultural diversity under the SLC test following the same way of operating as used when analysing the EU merger tests and case law.

Fourthly and finally, Article 81 of the EC Treaty was examined in order to complete the

²²⁰ Triangulation is a technique that brings together different methods and data sources in a study. Bryman, *supra*, n. 212, at p. 275. Triangulation utilises “multiple observers, theoretical perspectives, sources of data, and methodologies”. See Norman Denzin, *The Research Act in Sociology* (Chicago: Aldine, 1970), 310; Eugene Webb, *et al.*, *Unobtrusive Measures: Nonreactive Measures in the Social Sciences* (Chicago: Rand McNally, 1966), and Rudestam and Rae, *supra*, n. 212, at p. 100.

²²¹ David Deacon, *et al.*, “Collision or Collusion? A Discussion and Case Study of the Unplanned Triangulation of Quantitative and Qualitative Research Methods.” *International Journal of Social Research Methodology* 1 (1998): 47.

analysis of the European competition law. Without investigating Article 81, the analysis would have been limited to merger regulation only, which would not have presented the full spectrum of competition law. When analysing Article 81, a mode similar to the European merger regulation, was employed in order to find out the extent of its possible protection of competition and cultural diversity.

2.5.2. Historical Study

The analysis of competition law alone could not answer the research question because courts seem to view the record industry in a rather restricted and narrow way. Thus, when considering the research question, it was necessary to carry out a historical analysis looking into the record industry more broadly.

The focus of the historical analysis of the record industry was to look at consolidation because numerous studies tended to suggest that consolidation (market power) was analogous to a lack of diversity (as illustrated in Chapter 1). In this instance, considering both primary and secondary data plus industry statistics, triangulated the data.

2.5.3. Interviews

Looking at the issue of cultural diversity and competition law from a third data source, the interviews, then further triangulated the data. Whereas the historical study dealt with the evolution of the record industry and different competitive regimes, the interviews were aimed at examining the shifts and changes within the record industry, highlighting the tensions and differences between the majors and the independents. The interviews also helped to contrast certain attributes of major record companies with independent labels and analyse how big business, if at all, affected the small businesses and what impact that has had on cultural diversity. The interviews were also necessary to understand how the record industry has changed within the past decade, why independent labels are important, if indeed they are, and why those labels need to be protected by competition law. Eventually, the interviews combined with a historical study allowed me to analyse as to what extent competition law managed to regulate the

record industry, as part of cultural industries, and look into the tensions within the law itself, for example the seemingly opposite purposes of copyright and competition laws.

As the sample was stratified by working out key characteristics of record companies (size, business model, motivation, and the use of copyright), the interviewees reflected some differing viewpoints in the independent label sector.²²² Each of these key characteristics was important in relation to cultural diversity. Size showed that the majority of independent labels were more flexible in their approach than major record companies. The business model and motivation were important in terms of cultural diversity because they may have carried the notion of independence. The treatment of copyright was equally important in terms of increasing cultural diversity because many artists borrow from previous musical works, and the ever-lasting attempts by the majors' and now independents' trade bodies to extend the copyright term do not facilitate cultural diversity.

Thanks to the interviews, this thesis also provides a unique collection of data, e.g. a previously unknown methodology for calculating the market share data in the record industry, which is extremely important when considering the impact majors have on independents.

2.6. Additional Sources

In addition to the above analysis, peer review was used to challenge my conclusions and keep my mind open for all opinions by asking difficult and candid questions about data collection and data interpretation. Peer review included the reading of some of the chapters by other record industry participants and the crosschecking of different issues with them.

As a part of my research, I also attended the Winter Music Conference 2005 (Miami), which illustrated the role that independent labels played in releasing dance music in the USA. In addition, working for two years as a researcher for the record industry

²²² These characteristics were selected because they are in themselves noted as important generally in the record industry and fundamentally important in relation to my area of research. Size, business model, motivation and copyright are seen as defining characteristics within the sector because they denote the kind of artists labels signed and how they deal with them and their music.

network, MusicTank, allowed me to attend numerous music industry conferences and think tanks, such as In the City 2005 (Manchester), Music Works 2005 (Glasgow), Copyright conferences 2005-6 (London), London Calling 2006-07 (London) and numerous other panels.

Other secondary sources included material from industry journals, such as Music Week and Billboard, and the daily media including press, radio and television. Any project of this type collects an enormous range of news items, interviews and features from the above sources and this one has been no exception. There is a vast amount of news every day about the record industry. Being a music industry insider and researcher, I subscribed to the daily news bulletin, the Record of the Day, which collates significant stories about the music business every day from reliable and respected sources, such as The Guardian, The Sunday Times, The Telegraph, The Times, The Financial Times etc. There is also an abundance of on-line digital magazines, blogs and other Internet sources, which were treated with a great deal of caution; the data from which had been double-checked in the daily consumer media. Therefore, only sources regarded as authoritative and the data offered in them, have been used for the purposes of this research.

The resulting combination of the primary and secondary data has provided an up-to-date picture of the record industry in the twenty first century and its relationship with competition law, with all three methods facilitating the answer to the research question.

Having explained the methodology, the following chapter analyses the competitive dynamics in the record industry, as well as the differences between major and independent labels.

Chapter 3: History of Competitive Dynamics and Growth in the Record Industry: Diversity of Producers

The aim of this chapter is to evaluate historical patterns of growth and competition in the record industry from 1877 to the present day, helping to illustrate its competitive dynamics as well as major record companies' attempts to exercise control over the ownership of technology and music. The record industry's adaption to technological and structural innovation has always been significant in its development. In order to evaluate how competition law could regulate the industry, it is necessary to understand the industry's growth processes and patterns.

The structure of this chapter covers firstly the record industry's historical development, whilst the following part further explains the differences between major and independent record companies. The last part of the chapter looks into the importance of small and medium-sized record labels, elucidating why competition law should protect the diversity of producers

3.1. Cyclical Nature and Competition Patterns of the Record Industry

The history of the record industry, for purposes of this research, can usefully be broken down into nine time periods, characterised by different competition and growth patterns. The description of these periods will help to explain why the industry is what it is today, and with the assistance of the next chapter, should provide a full picture of *how* the industry has become so consolidated. This analysis also builds up the foundation for the further analysis of how competition law allowed such high concentration within the record industry.

3.1.1. Invention of the Phonograph and the Gramophone (1877 – 1909)

It was the invention of the phonograph by Thomas Edison in 1877, which gradually made possible the change of attitude from viewing music purely as an expression and art form, to music as a commodity²²³ and arguably, the possibility of music being utilised as a service.²²⁴ Back then, however, music was pre-industrial. Edison was convinced that the most important application of his invention would be the reproduction of speech for purposes of dictation and education. Having said that, the start was not a promising one - despite the phonograph being able to reproduce sound, it was difficult for recorded speech to be intelligible. Moreover, the recordings could not be preserved.²²⁵ The poor quality of the recordings plus the lack of the means to preserve them, blinded people to the prospective commercial value of the phonograph. Edison was so frustrated by that short sightedness that he gave up on his invention. Luckily, the phonograph was not forgotten. Further innovations followed and in 1885 Charles Sumner Tainter and Chichester Bell patented the graphophone, onto which sound could be permanently recorded.²²⁶

In 1887, ten years after Edison had created the phonograph, another American innovator, Emile Berliner, patented a better quality sound machine, called the gramophone.²²⁷ The gramophone was able to reproduce sound through a stylus moving horizontally over a rotating flat disc that sat on top of a turntable, which was different to Edison's drums used in the phonograph.²²⁸ Berliner could also see how his invention had potential for commercial exploitation through its use in a domestic setting as a means of musical entertainment, rather than simply for business use.²²⁹ Seeing that a supply of high-quality recordings was a prerequisite in making his product attractive to the consumer market, Berliner developed a system for the efficient manufacturing of high-fidelity recordings by using a zinc plate as a master record.²³⁰ There then followed

²²³ Simon Frith, "The Industrialisation of Popular Music," in *Popular Music and Communication*, ed. James Lull (London: Sage, 1992), 49.

²²⁴ David Kusek and Gerd Leonhard, *The Future of Music: Manifesto for the Digital Music Revolution* (Boston: Berklee Press, 2005).

²²⁵ Gronow and Saunio, *supra*, n. 211, at p. 3.

²²⁶ *id.*, at p. 4.

²²⁷ Kevin Daly, "Your Marvellous Invention: The Early History of Recording," in *The Music Goes Round & Round: A Cool Look at the Record Industry*, ed. Peter Gammond and Raymond Horricks (London: Quartet Books, 1980), 8.

²²⁸ Huygens *et al.*, *supra*, n. 214, at p. 985.

²²⁹ Frith, *supra*, n. 223, at p. 53.

²³⁰ Huygens *et al.*, *supra*, n. 214, at p. 985.

a total separation of the recording process from the reproduction of discs, which allowed Berliner to make further duplicates at less cost, with easier distribution and higher quality.

All of the above attempts to improve the phonograph did not go unnoticed by Edison himself and in 1888 Edison constructed his own improved machine by developing a spring-motor driven phonograph, which was very reminiscent of Berliner's invention and sparked a huge patent war with the latter.²³¹ At that time, the American businessman, Jesse Lippincott, solved the dispute by buying both patents and investing more than a million dollars in a company called the North American Phonograph Society, whose purpose was to exploit the invention commercially.²³² The company began leasing²³³ phonographs to offices as dictating machines, a mistake, which led the North American Phonograph Society into bankruptcy. Edison bought the patent rights back in 1889 and together with the Columbia Phonograph Company started selling the phonograph, firstly as a business aid²³⁴ and then for the first jukeboxes, fairs, and amusement centres.²³⁵ This venture marked the birth of the record industry. In 1901 the Victor Talking Machine Company was formed, followed by the British Gramophone Company. The historical background just described shows how important the monopoly control over patents was back then and may be seen in parallel with the present efforts by the majors to have a monopolistic control over copyright²³⁶ (see Chapter 4).

3.1.2. Creation of the Record Industry - The Stage of Low Concentration (1910 – 1928)

The historical evolution of the record industry, indeed like any other industry, has been home to cycles of booms and slumps which is important to take into account, when assessing the current situation of the record industry and its future development. The

²³¹ Gronow and Saunio, supra, n. 211, at p. 4 and Daly, supra, n. 227, at p. 7.

²³² Gronow and Saunio, id.

²³³ Nobody could purchase phonographs at that time. See Daly, supra, n. 227, at p.11.

²³⁴ id.

²³⁵ Gronow and Saunio, supra, n.211, at p. 4.

²³⁶ Jack Bishop, "Building International Empires of Sound: Concentrations of Power and Property in the Global Music Market." *Popular Music and Society* 28, no. 4 (2005): 444; and Andre Millard, *America on Record: A History of Recorded Sound* (New York: Cambridge UP, 1996), 65.

first boom time in the record industry occurred after World War I.²³⁷ Record sales around the world in the early 1910s were up to at least 50 million.²³⁸ By 1920, over 100 million records were sold in the US alone.²³⁹ Even at this early stage the gramophone companies realised that from a commercial point of view, it would be more profitable for them to make both the record equipment and the records, similar to hardware and software synergy these days.²⁴⁰ In other words “a company manufacturing gramophones but not records was rather like making razors but not the blades”.²⁴¹ This stage of the record industry produced a real boom and by 1929, about 50 percent of all US households owned a gramophone machine and in the same year, more than 150 million records were sold in the US alone, an increase of 50 percent compared to 1920.²⁴²

This period of the record industry can be described as a ‘low concentration’ stage thanks to new manufacturing technologies facilitating new entries into the recorded music market and the expiration of patents for playback devices, which reduced the cost of recording.²⁴³ Record companies were still part of the electrical goods industry,²⁴⁴ but they had already begun forming their release policies; namely, concentrating on a limited number of famous theatre and opera singers and cover versions of the same songs.²⁴⁵ Such practices can be described as a mould for contemporary record industry behaviour. This incredible expansion period in the late 1920’s came to an abrupt end with the onset of the Great Depression in the US.

3.1.3. Recession - The Stage of High Concentration (1929 - 1939)

The first record industry slump was caused by the Great Depression, coupled with a drastic change in people’s leisure habits,²⁴⁶ and the development of radio and cinemas, which enticed music-buying fans away. In fact, in 1923 the situation was so poor that

²³⁷ Frith, *supra*, n. 224, at p. 51.

²³⁸ Gronow and Saunio, *supra*, n. 213, at p. 12.

²³⁹ *id.*, at p. 28.

²⁴⁰ See Paul du Gay *et al.*, *supra*, n. 170, at pp. 75 – 83.

²⁴¹ Quoting Edward Lewis. Also cited in Frith, *supra*, n. 224, at pp. 53-4.

²⁴² Huygens *et al.*, *supra*, n. 216, at p. 988.

²⁴³ Peter Alexander, “New Technology and Market Structure: Evidence from the Music Recording Industry.” *Journal of Cultural Economics* 18 (1994): 117-8.

²⁴⁴ Frith, *supra*, n. 224, at p. 54.

²⁴⁵ Huygens *et al.*, *supra*, n. 216, at p. 988.

²⁴⁶ Frith, *supra*, n. 223, at p. 55.

the second largest company in the US, Columbia, nearly went bankrupt.²⁴⁷ On 24 October 1929 matters became much worse, with prices crashing on the Wall Street Stock Exchange in New York. Many companies, large and small, were forced out of business. In 1932, sales of gramophone records had fallen from 104 million in 1927 to 6 million²⁴⁸ and the number of phonograph machines manufactured had also diminished from 987,000 to 40,000.²⁴⁹ By 1933 sales were cut to a fraction of what they had been in the boom years of ‘gramophone fever’.²⁵⁰ However, this crisis produced a shift in music profits, from that of selling of records, to that of selling other assets. In 1928, for example, Warner realised the benefits of the back catalogues by acquiring Tin Pan Alley,²⁵¹ the first ever publisher²⁵² in the US. As will be shown in Chapter 4, majors to this day, invest hefty amounts to acquire back catalogues.

When the Great Depression struck, the choice the record companies faced was to either merge or face bankruptcy. During this slump period the number of independents declined, partly due to the prevailing economic conditions and partly due to the imitation by majors of genres and artists released on those small labels.²⁵³ This first crisis produced one salient outcome - the establishment of the record business as an oligopoly, i.e. the market was dominated by a small number of large or major record companies. For example, in the UK, The Gramophone Company and Columbia merged in 1931 under the name Electrical Musical Industries (EMI), after both companies’ turnover had plummeted by 90 percent.²⁵⁴

It was a new entrant to the market, Decca Records, which began to revitalise the market by realising the potential of the economies of scale.²⁵⁵ Jack Kapp and Ted Lewis founded Decca Records in the US in 1934. They soon understood that in order for their business to become highly successful, all they needed was a high volume of sales of just a few artists. They stopped investing money in gramophone manufacturing and instead concentrated solely on making and selling records; the diversity of music released declined but the quantity increased. Other big record companies followed Decca in

²⁴⁷ Gronow and Saunio, *supra*, n. 211, at p. 37.

²⁴⁸ Daly, *supra*, n. 227, at p. 28.

²⁴⁹ Frith, *supra*, n. 223, at p. 55.

²⁵⁰ Gronow and Saunio, *supra*, n. 211, at p. 57.

²⁵¹ Frith, *supra*, n. 223, at p. 56.

²⁵² See the glossary for the definition.

²⁵³ Alexander, *supra*, n. 243, at p. 119.

²⁵⁴ Gronow and Saunio, *supra*, n. 211, at p. 57.

²⁵⁵ For a detailed description of Decca’s influence see Huygens *et al.*, *supra*, n. 214, at pp. 989-990.

their organisational changes. Engineers and technical staff were no longer running record companies but instead, business-orientated people with strong personalities were in charge. Furthermore, brand new departments were staffed with large amounts of marketing employees. As a result, big record companies also started investing significant amounts of money advertising their stars and releases. Decca re-assessed popularity as something that transcended class differences; “the secret of success was to offend nobody”.²⁵⁶

As the big record companies preferred to concentrate on definite hits, less overtly commercial music such as jazz and rhythm and blues were out of the picture. Such a situation created a partial vacuum for people who wanted to listen to different kinds of music. The reason why non-mainstream music was not released by the majors was because at the time it was considered as ‘black’ or ‘race’ music.²⁵⁷ Having said that, already at such an early stage of the record industry evolution, there appeared small labels that filled the vacuum. These small labels predominantly catered for African-American musicians releasing ragtime, blues, jazz, and Charleston, which were snapped up by white performers to cover the popular black music of the era.²⁵⁸

3.1.4. Revival in the US, Recession in the UK during the World War II – The Stage of Corporate Concentration (1940 – 1949)

Whilst Europe was preparing for World War II, the record industry in America was enjoying a boom time again. In 1938, 33 million records were sold in the United States; in 1941 the figure had increased to 127 million.²⁵⁹ By 1939, RCA-Victor, Columbia, and Decca accounted for 100 percent of the mainstream market.²⁶⁰ However, after 1940, new players, such as Capitol, Mercury, and MGM jockeyed for position amongst the leaders.²⁶¹ The war did not stop the American record industry euphoria and by 1945

²⁵⁶ Frith, *supra*, n. 223, at p. 58.

²⁵⁷ William Barlow, “Black Music on Radio during the Jazz Age.” *African American Review* 29, no. 2 (1995): 325 and Arnold Shaw, *The Jazz Age* (Oxford: Oxford University Press, 1987), 1 – 87.

²⁵⁸ Barlow, *id.*

²⁵⁹ Peter Gammond, “Coming of Age: Recording in the LP Era,” in *The Music Goes Round & Round: A Cool Look at the Record Industry*, ed. Peter Gammond and Raymond Horricks (London: Quartet Books, 1980), 28.

²⁶⁰ Dowd, *supra*, n. 128, at p. 7.

²⁶¹ Russell Sanjek and David Sanjek, *American Popular Music Business in the 20th Century* (New York: Oxford University Press, 1991). Also cited in Dowd, *id.*, at p. 3.

the structure of the record industry was well defined: the production of music turned into a conveyer-type process predominantly concentrated in a handful of majors.²⁶²

By contrast, the European record industry was very much struggling during the War as a result of the rationing of shellac. Both Columbia's office in London and the Deutsche Grammophon office in Berlin were destroyed by bombing raids. However, Europeans struggled to afford records, constrained by the ongoing rationing that continued long after the war had ended.²⁶³ Record sales in the United States in 1950 were worth £37 million, compared to only £2.5 million in England.²⁶⁴

Post war the situation gradually improved. The period between 1948 and 1955 could be described as one of *corporate concentration*.²⁶⁵ During this period four companies dominated the record industry, those being RCA Victor, Columbia, Decca and Capitol together holding a total market share of 75 percent. Such high market concentration²⁶⁶ was achieved because of the vertical integration²⁶⁷ of the four companies. The then Big Four controlled the entire production flow from raw materials to distribution and had the great advantage of their marketing and corporate links with radio and movie companies.²⁶⁸ Such a solid grasp of marketing and distribution by the majors in turn resulted in low diversity levels. For example, the 1947 hit songs 'Near You' and 'Open the Door, Richard', were initially released by independent labels. However, both songs were subsequently covered by the then four major record companies, leading to a situation where both songs had *five* versions in the top ten hit parade.²⁶⁹ Majors thus successfully learned to use three tactics to increase their market share:²⁷⁰ to produce more cover versions of the songs that proved successful on independent labels, to sign artists away from independent companies, and to merge with each other and acquire independent labels.

²⁶² Frith, *supra*, n. 223, at p. 58.

²⁶³ Gronow and Saunio, *supra*, n. 211, at p. 118.

²⁶⁴ *id.*

²⁶⁵ Peterson and Berger, *supra*, n. 104, at p. 160.

²⁶⁶ Other industries have an even higher concentrations ratio, for example, automobile and electrical industries. *id.*, at p. 161.

²⁶⁷ See the glossary for the definition.

²⁶⁸ Peterson and Berger, *supra*, n. 104, at p. 162.

²⁶⁹ *id.*, at pp. 162 – 163.

²⁷⁰ Black and Greer, *supra*, n. 112, at p. 15.

Importantly, major record companies were able to transform radio from a rival to a collaborator. Radio, with its nation-wide coverage, became the new outlet to promote new and unknown artists. At the same time the record industry was facing a new ‘threat’ following on from radio, that of television. Again, the majors showed their initial resistance to technological novelty, although television would eventually have a huge impact on their development and massive increase in their profit levels.²⁷¹ The record industry had clearly entered a period of growth, one that started in the 1950s and ended in the late 1970s.

3.1.5. The Arrival of Independents and New Music Genres – The Stage of Low Concentration (1950 – 1959)

A new surge of diversity occurred in the 1950s due to new production techniques becoming available. Magnetic recording tape became available and allowed for further innovation as well as a reduction of production costs.²⁷² Moreover, there was another crucial development in the record industry, namely that of a marked division into ‘majors’ and ‘independents’. Between 1956–1959 there was a period of *stronger competition*²⁷³ during which independent music labels arose, introducing more genres that the majors were not ready to release such as rhythm and blues, gospel and jazz: “with the exception of Buddy Holly and Bill Haley, all of the new generation of dancing teenagers first recorded for independent recording companies”.²⁷⁴

The success of the independents in the US was caused by a number of factors. In 1948 the US Supreme Court ruled that film companies had to sell their theatre chains. This meant the end of the domination of the American movie industry by the eight major Hollywood film companies because they had to cut down the production of musicals with new songs.²⁷⁵ Moreover, by 1951 television was becoming more popular and enticing people away from cinemas back to the comfort of their homes.²⁷⁶ All these events had a great impact on the record industry and happened at a time when small independent but highly entrepreneurial labels, such as Atlantic, Chess, Imperial, Dot

²⁷¹ Frith, *supra*, n. 223, at p. 59.

²⁷² Alexander, *supra*, n. 243, at p. 114.

²⁷³ Peterson and Berger, *supra*, n. 104, at p. 164.

²⁷⁴ *id.*

²⁷⁵ *id.*

²⁷⁶ *id.*

and Sun Records flourished and were in the position to provide real competition to the majors.

Independent music labels had become an alternative to majors, and by encouraging creativity and experimenting with more varied styles and sounds they tested markets for the entire industry.²⁷⁷ It is worth noting that one of the most successful stars in the history of music, Elvis Presley, started on an independent music label, Sun. Initially the majors had refused to sign Presley, because at that time 'rock-n-roll' was still regarded as a dangerous novelty. Only after the then major record company RCA realised his commercial appeal, was Presley signed.²⁷⁸ However, despite the acceptance of Elvis Presley, the record business was still reluctant to embrace rock'n'roll as a genre. For example, the Beatles' were rejected by all major companies before Parlophone took an interest in them, and the Beatles' first American single was licensed to three independent labels: Swan, Tollie and Vee-Jay, as Capitol had thought it too risky to release the Beatles' records in the States.²⁷⁹ This short-sightedness demonstrated that as a result of the majors' inflexibility, there were a lot of gaps waiting to be filled by the independents. Additionally, the low costs of tape recording and the mobility of its equipment enabled independents to produce recordings at acceptable costs. The distribution patterns had also widened and apart from the traditional retailers, records were also sold by mail and via record clubs.²⁸⁰

In the late 1950s, the independent record sector was responsible for a significant increase in the diversity of records, such as Elvis Presley, Jerry Lee Lewis, Chuck Berry, and Little Richard. For the first time in history, independents could provide strong competition to the majors and the diversity of producers thereby increased musical diversity in general. Whereas in 1955 the big four majors had owned approximately 75 percent of the \$277 million US record market, by 1959, their share had tumbled to 34 percent of a growing market that had reached a value of \$603 million,²⁸¹ with the independents enjoying an impressive 66 percent of the recorded music market. By 1962, the independents held 75 percent of the market share.²⁸² The

²⁷⁷ Burnett (1996), *supra*, n. 120, at p. 80.

²⁷⁸ Frith, *supra*, n. 223, at p. 63.

²⁷⁹ Serge Denisoff, *Tarnished Gold: The Record Industry Revisited* (New Brunswick, NJ: Transaction Books, 1986), 88.

²⁸⁰ Huygens *et al.*, *supra*, n. 214, at p. 991.

²⁸¹ Black and Greer, *supra*, n. 112, at p. 15.

²⁸² Alexander, *supra*, n. 243, at p. 120.

general demographic trends were important factors in the spectacular profits seen by the record industry in the 1950s, namely that of young people purchasing music after World War II and growing economies in both the US and the UK as well as an overall increase in the standard of living following the war.

3.1.6. The Arrival of Beatlemania - The Stages of Secondary Consolidation, Renewed Growth and Re-Concentration (1960 – 1978)

The period from 1959-1963 could be described as *secondary consolidation*,²⁸³ and it saw the rise of new leading companies, such as MGM and Warner Brothers, together with a number of those independents holding a strong market position.

By 1964, the big four majors realised that the music styles of R&B and rock'n'roll were not just passing fads. The market had continued to grow and this growth could be attributed to the independents' discovery of these music genres that appealed more to a younger generation. Once again, similarly to when Decca arrived, the big four were learning from new entrants how to reorganise their traditional marketing strategies. They placed more emphasis on discovering and developing new talent; consequently A&R (Artist & Repertoire) departments were created.²⁸⁴ The Big Four started releasing acts like the Beach Boys and Bob Dylan.²⁸⁵

The next period of *renewed growth*²⁸⁶ from 1964 – 1969 was fuelled by the British musical invasion, particularly of Beatlemania. During this period record sales were higher as was the concentration within the industry; this situation is somewhat in contradiction to the norm, namely the relationship between diversity and concentration levels is usually an inverse one (see Chapter 1).

In 1960, US record sales had reached a peak value of \$600 million.²⁸⁷ Small cheap cassette recorders were being produced and expanded the customer base of recorded

²⁸³ Peterson and Berger, *supra*, n. 104, at p. 166.

²⁸⁴ For more on A&R see Keith Negus, *Producing Pop: Culture and Conflict in the Popular Music Industry* (London: Arnold, 1992), 80-81 and Elisa Bray, "The Big Question: What are A&Rs, and Can a Record Company Survive without Them?", *The Independent*, February 29, 2008.

²⁸⁵ Huygens *et al.*, *supra*, n. 214, at p. 992.

²⁸⁶ Peterson and Berger, *supra*, n. 104, at p. 167.

²⁸⁷ Gronow and Saunio, *supra*, n. 211, at p. 96.

music too, thereby contributing to high music sales. The LP format introduced into the market by CBS-Columbia in 1948 also proved extremely popular.²⁸⁸ In 1967, the sales achieved by the American record industry were in excess of one billion dollars and just six years later surpassed two billion dollars.²⁸⁹ By 1978, global sales had reached \$7 billion.²⁹⁰

This period of the development of the record industry from 1970-1973 can be described as a *re-concentration*.²⁹¹ During this short time, the level of concentration increased by about one third. Majors achieved a new level of market strength by displacing independents, either by acquiring them or by buying their main acts. At the time, Warner Communications and Columbia each had a market share of 15 percent; Capitol was in third place thanks to the Beatles, with Motown and A&M being the only independents in the top eight record companies. However, with those two important exceptions, the remainder of the companies were vertically integrated corporations. Having strong financial power, the majors regained control over the three key areas of production, distribution, and marketing.²⁹²

3.1.7. Recession— The Stage of Low Concentration (1979 - 1984)

The immense growth of the previous period was followed by another crisis lasting from 1979 to 1984. The slump could be explained by the cycles of competition, but more importantly, there were social and economic changes, including an increasing number of people over 25 and a high level of unemployment.²⁹³ The American economy was at its weakest point since the Depression of the 1930s as the oil crisis affected automobile and retail sales too.²⁹⁴ On the whole, consumers had less money to spend on leisure. In addition to that, there was a lack of quality and diverse music. As Lee Hartstone remarked: “If the best the industry can do is give us two hit LPs (Bee Gees and Rod Stewart), it is pretty damn weak”.²⁹⁵ Interestingly, it was at this time that independents in the UK championed a new genre, punk rock, as an antidote to the disco genre that

²⁸⁸ *id.*, at p. 98.

²⁸⁹ Frith, *supra*, n. 223, at p. 64.

²⁹⁰ Burnett (1990), *supra*, n. 120, at p. 6.

²⁹¹ Peterson and Berger, *supra*, n. 104, at p. 168.

²⁹² *id.*, at p. 170.

²⁹³ Frith, *supra*, n. 223, at pp. 66-7.

²⁹⁴ Denisoff, *supra*, n. 279, at p. 108.

²⁹⁵ Also cited *id.*, 109-10.

was championed by the majors. Also technological advances, such as home tape recorders and videocassette recorders, meant that the consumers would be less liable to spend money on music. Once again, the symbiotic link between technology and the industry is demonstrated by the latter having opposed technological development in the form of videocassette recorder (hereinafter, the VCR). The VCR caused much controversy over the issue of copyright and profits' loss culminating in the *Sony v. Universal Studios* decision in 1984.²⁹⁶ The Supreme Court ruled in favour of Sony that home videotaping for private use was legal, and off-air taping was not a copyright infringement, as Universal Studios and its allies had claimed. Eventually, the record industry made the move to embrace video recorders, particularly when they started selling their artists' concerts and video clips on videocassettes.

3.1.8. Revival – The Stage of High Concentration (1984 - 1999)

From 1983-84, the record industry started its recovery and gradually entered a new boom time. Bobby Colomby explained that there were three reasons for the recovery of the industry: MTV, Compact Discs (hereinafter, CDs), and Michael Jackson.²⁹⁷ MTV changed the perception of music because the visual aspect of the industry arguably took over the musical aspect. CDs allowed consumers to replace their existing collections on tapes and LPs thus generating more profit for the majors as they simply re-released their back catalogues,²⁹⁸ which was less expensive than investing money in new artists and content. Akin to the time when Warner acquired Tin Pan Alley, having realised the importance of their back catalogues, majors turned their attention to acquiring independent publishing companies as well as independent labels, e.g. Chrysalis and Virgin. Importantly in terms of this study, the competition authorities on both sides of the Atlantic showed indifference, by allowing these acquisitions, disregarding the effect that the higher concentration of the record industry thereby had on cultural diversity (this is analysed in Chapters 4 and 5). The main aim of such acquisitions was to acquire vast numbers of copyrights in already successful songs (this policy is discussed in Chapter 4). Thus the emphasis in the record business shifted from manufacturing and distribution of records to the transfer and exploitation of copyrights.²⁹⁹ Finally, in

²⁹⁶ 464 U.S. 417 [1984].

²⁹⁷ Interview with Bobby Colomby, 26 September 2007.

²⁹⁸ Burnett (1990), *supra*, n. 120, at p. 7.

²⁹⁹ Huygens *et al.*, *supra*, n. 214, at p. 994.

timely fashion, Michael Jackson released his record-breaking Thriller album, which single-handedly saved CBS Records (now Sony) from financial ruin. All these events meant that the record industry was at its nadir. By 1989 music sales reached \$22 billion³⁰⁰ and they kept growing until 2000.

3.1.9. Recession - Digital Revolution: The Stage of Higher Consolidation (2000 - onwards)

In 2000, music sales reached the mark of \$36.9 billion³⁰¹ and since then they have been on a decline. By 2004, the global music market was worth \$33 billion.³⁰² This is still an impressive figure, but the record industry became increasingly unstable due to the onset of the digital era.³⁰³ Despite these difficult times, majors still managed to hold onto their market share and even slightly increase it in the digital age, as demonstrated below in Table 1.

³⁰⁰ Burnett (1990), *supra*, n. 120, at p. 7.

³⁰¹ International Federation of the Phonographic Industries (hereinafter, IFPI) Report, "The Recording Industry in Numbers", 2001.

³⁰² IFPI Report, "The Recording Industry in Numbers", 2005.

³⁰³ Daniel Lee, "First Against the Wall in the Online Music Revolution," *The Guardian* (Media Law Music Supplement), March 10, 2008, 2; Adam Smith, "The Music Industry: Lost in the Shuffle," *The Time*, March 19, 2008; Andrew Leyshon *et al.*, "On the Reproduction of the Musical Economy after the Internet," *Media, Culture & Society* 27, no. 2 (2005): 179 – 18; Ethan Smith, "Sales of Music, Long in Decline, Plunge Sharply: Rise in Downloading Fails to Boost Industry," *The Wall Street Journal*, March 21, 2007; Brian Hiatt and Evan Serpick, "The Record Industry's Decline," *The Rolling Stone*, 19 June 2007; Ed Christman, "Sony BMG Loses \$49 Million Last Quarter," *The Billboard*, July 29, 2008. Traditionally, music sales pick up in the run up to Christmas. See Andre Paine, "Strong Q4 Sales for U.K. Biz," *The Billboard*, January 6, 2009.

**Table 1: Major and Independent Record Companies' Market Share
for 2002 – 2008.**

	2002 ³⁰⁴	2003 ³⁰⁵	2004 ³⁰⁶	2006 ³⁰⁷	2007 ³⁰⁸	2008 ³⁰⁹
EMI	12.3	13.5	13.4%	12.8%	11.8%	11.3%
SonyBMG	22.2	22.1	21.5%	21.2%	18.9%	19.1%
Universal	25.3	23.4	25.5%	25.7%	27.7%	29.0%
Warner	11.6	12.5	11.3%	13.8%	14.5%	14.8%
Independents	28.5	28.5	28.4%	27.5%	27.1%	25.8%

Table 1 demonstrates that the market share of majors is slightly on the increase, whereas the independents' share dropped just under two percent. Most importantly, the independents' market share has actually dropped in the *digital* age. That lack of growth of the independents' market share in the digital age, which affords very cheap technology for making and selling music, alerts one to think as to whether independents can provide an effective competition to majors in the promising digital age.

Nearly every month there is new research on the market showing the decline of CD sales, for example, the research by the NPD group (leading provider of retail marketing information) pointed out that CD sales fell by 19 percent in 2007, whilst 48 percent of US teenagers did not purchase a single CD that year.³¹⁰ Even without questioning the

³⁰⁴ IFPI Report, "The Recording Industry in Numbers", 2005. In calculating the market share, the IFPI considered all sales of a record company's music products including *licensed-in* products. The rationale for this is that the risk of a licensing deal lies with a licensee (predominantly, a major). When a major signs a licensing deal with an independent music label, the outcome is that an independent label sells its product to that major for a fee, with the major selling it worldwide. It may turn out to be that a major might either lose or make money on the product and that is why the sales are booked to that particular major. All licensing deals were counted as a majors' market share. The above offers an explanation as to why, in the digital age when independent labels are set up almost on a daily basis, their market share is falling, and when a major acquires an independent label, the latter also becomes a major for the IFPI statistics. Interview with Keith Jopling, 06 February 2006.

³⁰⁵ IFPI Report (2005). *id.*

³⁰⁶ *id.* IFPI does not provide the market share data as of 2006. Hence, there is no market share for 2005.

³⁰⁷ Music & Copyright, Informa UK Limited, 2007. It should be noted that the IFPI do not endorse the market share calculation by Music & Copyright. Telephone conversation with Gabriella Lopes, Director of Market Research, IFPI, 02 September 2009.

³⁰⁸ Music & Copyright, (2008).

³⁰⁹ Music & Copyright, (2009).

³¹⁰ The Economist, *supra*, n. 88; Jack Schofield, "In the US, 58% of Music Isn't Paid for," *The Guardian Unlimited*, April 18, 2008; Mark Hefflinger, "Survey: Teens Buying Fewer CDs, Downloads; P2P also Down," *Digital Music Wire*, March 31, 2009. According to research carried out in the UK, 61 percent of teenagers do not feel they should pay for their music records. See Jemima Kiss, "Britain's Young People

validity of these studies, it is obvious that eventually and perhaps sooner than later, the CD will lose its dominance due to digital downloads.³¹¹ This trend is already more obvious in the US. Even though digital downloads will eventually overtake the sale of the CDs, to date the revenue from downloads is not enough to compensate majors for the loss of CD sales.³¹² In an attempt to save declining income, major record companies pointed their finger to illegal file-sharers and illegal file-sharing websites (Peer-2-Peer).³¹³ The majors' crusade against such file-sharers culminated in thousands of lawsuits on both sides of the Atlantic.³¹⁴

However, what the record companies overlooked was the ever-increasing power of supermarkets and Internet Service Providers (hereinafter, the ISPs) which now dictate conditions to the majors (see the discussion below in Chapter 4). Likewise, mobile phone operators and telecoms are dwarfing the record companies in terms of their power and revenue. This is coupled with the fact that the content released by the majors is far from being heterogeneous.³¹⁵ Rosters of artists have been dramatically reduced, and perhaps for the first time in history of the record industry, the function of talent development shifted from A&R to the marketing departments.³¹⁶ These factors can be added to the old business models the majors are still using, increasing their general inflexibility and fear of what results they are going to report to the shareholders. Majors also paid little attention to needless expenses and huge advance payments to the

Want Music More than Sex - but for Free," *The Guardian*, February 17, 2009; *Human Capital Research for Marrakesh Records*, "Youth and Music Survey." (2009).

³¹¹ CDs are to be removed from a typical basket of UK foods. *BBC*, "Muffins Enter Typical UK 'Basket,'" March 17, 2008. The level of the transformation of the record industry can be seen from the inclusion of albums sold on USB Flash drives into the Official UK Charts Company. See Tony Smith, "UK Charts Company to Recognise Album Sales on USB Flash Disks," *The Register*, October 25, 2007.

³¹² Charles Arthur, "Record Sales Can't Get Music Companies off the Hook," *The Guardian*, January 8, 2009.

³¹³ Since 2004, more than 20,000 lawsuits against illegal file-sharers have been brought in the US alone. For more see Jon Robins, "File Sharing: In the Dock," *The Guardian* (Media Law Music Supplement), March 10, 2008, at p. 2; John Alderman, *Sonic Boom: Napster, P2P and the Battle for the Future of Music* (London: HarperCollins, 2001); Steve Knopper, *Appetite for Self-Destruction: The Spectacular Crash of the Record Industry in the Digital Age* (New York: Free Press, 2009). See also *MGM Studios, Inc. v. Grokster, Ltd.* 545 U.S. 913 [2005].

³¹⁴ Many argue that P2P did not cause the decline of majors (this debate is outside the scope of this research). For more see Knopper, *id.*, at pp. 157 – 183.

³¹⁵ This fact has been emphasised even by the European Competition Commission in Sony/BMG merger case, Case No COMP/M.3333 – *Sony/BMG*, July 19, 2004, para 58. This is discussed further in Chapters 4 and 5.

³¹⁶ As the Chief of EMI noted: "What we are doing is taking the power away from the A&R guys and putting it with the suits – the guys who have to work out how to sell music." Also cited in Richard Ray and Owen Gibson, "Leave Talent Spotting to the Suits, Says EMI Boss," *The Guardian*, February 28, 2008.

artists,³¹⁷ which cost the big four millions of pounds every year. Just as it seemed that matters could not become any worse, a number of A-list stars left the major record companies.³¹⁸ Two of the four majors, that are unaffiliated, Warner and EMI, suffered the most because as opposed to Sony and Universal, they could not derive any protection from the parent companies.³¹⁹

In the digital age majors simply repeated the same mistakes they made when radio, television and videocassette recorders appeared in the market.³²⁰ Instead of embracing the opportunities offered by digital technology, they once again rejected them. Interestingly enough, whilst majors again fell into the trap of refusing to embrace a technological breakthrough, the independents were the first to realise the potential offered by digital technology as an inexpensive new form of recording and distribution to increase the diversity of musical content in the marketplace,³²¹ i.e. the Long Tail. However, the ease of copying digital material with no perceived generation loss has made piracy much more rife than previously.

In the eyes of the majors there could only ever be two responses to the market crisis, being that of lobbying for the legislative change to extend the copyright in sound recordings (discussed in Chapter 4) and higher consolidation by mergers and acquisitions. Starting from the year 2002 there has been an unprecedented wave of mergers and acquisitions in the record industry, including the infamous merger between Sony and BMG (this merger is analysed both in Chapter 5 and the Conclusion), as well as the chain of acquisitions by Universal of a BMG publishing catalogue and a plethora of other labels (this is also discussed in Chapter 5).

³¹⁷ Dan Sabbagh, "Guy Hands Aims to Snuff Out Excesses that Cost EMI £100m a Year," *The Times*, November 29, 2007.

³¹⁸ Quoting Paul McCartney: "I write it, I play it, I record it, and that's all fun. And you go to the record company, and it gets very boring. You sit around with people, and you are almost falling asleep... and they are almost falling asleep." Also cited in Kim Murphy, "Paul McCartney Is a Man on the Run," *The Los Angeles Times*, June 3, 2007; Dan Sabbagh, "Sir Paul McCartney Puts his Disillusion with EMI on Record," *The Times*, December 14, 2007; Jeff Leeds, "McCartney Signs with Starbucks for his Next Album," *The New York Times*, March 22, 2007; Katie Allen, "Material Girl Says Goodbye to Warner to the Tune of \$120m," *The Guardian*, October 12, 2007; Chris Ayres, "Power of Goodbye: Madonna Split May Herald Record Industry's Death," *The Times*, October 12, 2007; and *The Telegraph*, "Paper Pays £500K to Give Prince's New Album Away," June 30, 2007.

³¹⁹ *The Economist*, supra, n. 88.

³²⁰ Dwight Garner, "When Labels Fought the Digital, and the Digital Won," *The New York Times*, January 6, 2009.

³²¹ For more see McLeod, supra, n. 200, at pp. 521 – 531.

At the same time, the crisis of the record industry once again spawned a spurt of entrepreneurship, with many artists and music industry figures setting up their own labels. Thanks to the prevailing digital technology, many small labels were able to record and release their music (predominantly online), as the costs of recording and digital distribution were no longer prohibitive.³²² This process has to a certain extent, eroded higher concentration within the record industry. However, as will be shown in Chapter 4, majors are still holding a grip on such important areas as the marketing, promotion, and physical distribution of music, thus preventing independents from competing effectively. Hence, in this study it is argued that independents cannot compete with majors in those areas of marketing and distribution, leading to lower levels of music diversity.

Before going into a discussion of competition in the record industry it is necessary to provide a further, more detailed explanation of the role of both majors and independents; on what makes them different and accordingly what is their impact on cultural diversity. It will also help answer the research question of *why*, if at all, competition law should protect small businesses in cultural industries.

3.2. Majors and Independents

“[We were] too big to be small, too small to be big.”

Chris Blackwell³²³

“Corporations cannot be involved in creative force – it is nonsense.”

Pete Jenner³²⁴

“If I said I found the next Sonny Rollins, do you think majors would care?”

Bobby Colomby³²⁵

Whilst the historical analysis has illustrated that traditionally record companies have been classified into two groups: ‘majors’ and ‘independents’, this section looks at the main characteristics and differences between majors and independents, with the

³²² It only applies to the recordings of a low and moderate quality.

³²³ Quoting Chris Blackwell (founder of Island Records) by Marc Marot at MusicTank seminar “Label Mergers: Bigger’n’Better’n’Rougher’n’Tougher.” 18 May 2004.

³²⁴ Quoting Pete Jenner at MusicTank seminar, id.

³²⁵ Interview with Bobby Colomby, *supra*, n. 297.

emphasis on the controversial issues such as profit making and selling business to bigger companies. The backdrop of this section is that there have always been two extreme points of view about the two types of record companies. One is that multi-national corporations care about commerce, whilst small labels care about cultural diversity. In order to avoid accepting pre-formed categories, this section initially analyses these preconceptions. Bearing in mind the stature of the interviewees and their pertinent responses, for this particular section, I purposely preferred to concentrate mainly on the outcome of the interviews where appropriate rather than secondary sources. This approach allows the reader to obtain a unique and up-to-date picture of the record industry from top music industry figures.

3.2.1. Characteristics of Major Record Companies: Evolution of the Record Industry Oligopoly

The majors are large, international record companies, currently Universal, EMI, Sony and Warner, each of them having a network of owned or affiliated companies worldwide with their own local distribution chains through which they can market repertoire predominantly with international potential; they dominate the record industry's market output and earnings. The majors are both horizontally and vertically integrated to varying degrees and undertake a wide range of activities from discovering and developing new recording artists and repertoire to distributing, marketing and promoting the records.

The historical discourse demonstrated that the record industry evolved through different stages of oligopoly. This section documents how the Big Four established their dominance through their control of creative and distribution chains.

1) Universal Music Group

Universal's legacy can be traced back to 1906 when Carl Laemmle opened his first nickelodeon theatre in Chicago.³²⁶ Six years later, Laemmle incorporated the name

³²⁶ The timeline of the Universal history (except the PolyGram description) is taken from Universal Music official website, <http://new.umusic.com/History.aspx>. For more on Universal Music Group history see Bishop, *supra*, n. 236, at pp. 448 – 449.

‘Universal’ when he formed the Universal Film Manufacturing Company in New York. In 1936 Universal was sold to the Standard Capital Company and ten years later it merged with International Pictures. In 1952 the English label, Decca Records purchased a controlling interest in Universal Pictures. Six years later, Music Corporation of America (hereinafter, MCA) purchased the Universal Studios Property and Paramount’s pre-1948 film library for its MCA TV division, incorporating everything under the name MCA. However, the proposed merger of MCA-Decca-Universal was banned for violating the US anti-trust laws.³²⁷ Still, it did not prevent MCA from acquiring such influential independents as ABC Records, Motown, and Geffen Records. In 1991 the Japanese electronics giant, Matsushita, the parent company of Panasonic, acquired MCA for \$6.6 billion.³²⁸ At the time, the deal made Matsushita the largest entertainment conglomerate in the world consisting of: Universal Pictures, Universal TV, MCA Home Video, MCA Records and other smaller holdings. The music division was an important but still very small part of MCA/Universal. Up until 1998, the market share of the music group accounted only for 3.6 percent.

In 1995, Seagram (the world’s largest drinks manufacturer) acquired an 80 percent interest in MCA. Following that, in 1998, Seagram purchased PolyGram for \$10.6 billion and merged it with MCA to create the Universal Music Group. As MCA was acquiring and being acquired, two of the world’s largest electrical engineering and electronics companies, Phillips and Siemens, became major players in the music industry.

Siemens had originally founded Deutsche Grammophon in 1898 to offer a line of classical recordings. In 1924 following the demand, Siemens launched a second label, Polydor, to release commercial pop music.³²⁹ Philips as a corporation was founded in 1891 but entered the music business in 1950. A decade later Philips acquired Mercury Records and two years later with Siemens, established a joint venture linking the Deutsche Grammophon and Philips under the name Phonogram.³³⁰ Finally, in 1972, Philips and Siemens combined Phonogram with Polydor to create PolyGram. The latter bought out several labels in the United States, most notably MGM and Verve, and took over the United Artists record distribution system.

³²⁷ Sanjek and Sanjek, *supra*, n. 261, at p. 153.

³²⁸ Millard, *supra*, n. 236, at p. 344.

³²⁹ Brian Southall, *The A – Z of Record Labels* (London: Sanctuary, 2000), 143.

³³⁰ *id.*, at p. 140.

Having gone through a substantial restructuring in the 1990s within Phillips, PolyGram, through both vertical and horizontal integration, was able to enjoy a great deal of success from the 1990s onwards.³³¹ PolyGram's further success was owed in no small part to the fact of it owning one of the best rock/pop and classical catalogues in the world as well as being responsible for the discovery of new acts, for example those that fitted into the heavy metal group genre. In the mid 1990s, PolyGram provided a successful portion of corporate profits but this was still not enough to prevent it from being acquired by Seagram. As mentioned earlier, in 1998 Seagram purchased PolyGram and merged it with MCA to create Universal. This very merger established Universal as the *world's largest music company*. In 2000 Universal changed ownership again. At the time of writing, Vivendi and Canal+, a French media giant, own Universal.

2) Sony Music Entertainment

Sony traces its roots back to 1888 when Columbia was the US sales representative for the Edison phonograph.³³² In 1938 the Columbia label was acquired by the Columbia Broadcasting System (hereinafter, the CBS). Ten years later, Columbia introduced the Long Playing (LP) format that became the music industry standard for the next 50 years. In 1953, CBS launched Epic Records, which would have unprecedented success with the artists like Michael Jackson, Sade, Gloria Estefan, George Michael, and Cyndi Lauper. During the 1960s, 1980s and 1990s, CBS Records was one of the most successful record companies in history. In 1988 however, the Japanese corporation Sony Electronics, acquired CBS Records for \$2 billion, following which its name was changed to Sony Music. The following year, Columbia Pictures was added to its structure, continuing the corporation's chain of acquisitions, helping the Sony Corporation of Japan to grow in force as a multi-media entertainment empire. In 1991, the Sony Software Corporation was formed in order to oversee the record business arm of the 'empire', and was subsequently renamed Sony Music Entertainment.

³³¹ Negus, *supra*, 56, at p. 42.

³³² For more on the evolution of Sony see *id.*, at pp. 40-42; Bishop, *supra*, n. 236, at pp. 449 – 450 and Millard, *supra*, n. 236, at pp. 340 - 344.

In 2004 Sony merged its record music division with BMG (Bertlesmann Music Group), a German record company owned by Bertlesmann (the world's largest media conglomerate prior to the Time-Warner merger).³³³ Bertlesmann Media Group's origins can be traced back to 1935 when it started publishing books and, then later, magazines. In 1958, Bertlesmann founded its first music label Ariola Records. In 1979 BMG also acquired Arista - one of the most successful independent music labels, which had Whitney Houston on its roster, and in 1986 it acquired Radio Corporation of America (hereinafter, the RCA). The latter acquisition provided BMG with the invaluable rights to the Elvis Presley back catalogue. In the 1990s BMG established a few high profile joint ventures with LaFace Records and Bad Boys Records. Finally, in 2003 BMG acquired Zomba Records (one of the biggest independent labels in Europe). Like other majors, BMG's objectives were aimed at focussing on their established artists rather than signing and developing new ones. As mentioned above, in the digital turmoil, BMG decided to merge its music division with Sony's forming one company under the name SonyBMG (this merger represents a significant part of this study and is analysed in greater detail in Chapter 5), resulting in the second largest record company after Universal. However, in August 2008, having gone through an unprecedented merger saga, BMG decided to sell 50 percent of its stake to Sony³³⁴ and to date the new company is titled Sony Music Entertainment International.

3) Warner Music Group

The Warner music group has its origins in 1923 when the Warner Brothers Studios was co-founded by four brothers.³³⁵ Later, when Steve Ross, president of Kinney Corporation, which specialised in funeral parlours, car hire and car parks,³³⁶ gained financial control of the holding company, he reconfigured Warner's music department. This included acquiring three of America's most successful independent labels: Atlantic, Electra, and Asylum, forming at the time the most powerful major record company in the world. Steve Ross' innovation was the 'label federation' concept, in which each of the labels held were still able to operate fairly independently and enjoy a certain level of autonomy within the larger corporate structure.³³⁷ This allowed the

³³³ For more on the evolution of BMG see *id.*, at pp. 38-9.

³³⁴ For more on that acquisition see the Conclusion.

³³⁵ For more on the evolution of Warner see Bishop, *supra*, n. 236, at pp. 450 – 451.

³³⁶ John Qualen, *The Music Industry: The End of Vinyl?* (London: Comedia Publishing Group, 1985), 17.

³³⁷ Huygens *et al.*, *supra*, n. 214, at p. 992.

labels to retain their individuality as was suited to their different target markets. In the following decades Warner acquired London Records, Frank Sinatra's Reprise Records, and established Warner Western and Maverick Records.

Warner Brothers' dual music and film production resulted in a very successful business, with Warner's music division going on to become the US market leader in the late 1960s – a considerable achievement, given Warner's diversification into the recorded music market only a decade earlier. In 1989 Warner Communications merged with Time Inc. making Time/Warner the largest media conglomerate in the world. However, due to the immense debt and a series of poor results, a number of groups including Warner Music Group had to then be sold. Currently, Warner is owned by a group of venture capitalists.³³⁸ Its publishing arm, Warner Chappell Music, owns one of the best publishing catalogues in the world, with artists like Alanis Morissette, Madonna, and REM. Warner, to date, is the *only* American-owned company in contrast to Sony or Universal.

4) Electric & Musical Industries

EMI was established in 1897 originally under the name of The Gramophone Company.³³⁹ In 1899, the company acquired the infamous Francis Barraud's painting, 'His Master's Voice', and adopted the image and title as its trademark, which is still used today by HMV. Its first major artist in 1902 was Enrico Caruso. EMI as it is known today was formed in 1931 as a result of a merger between Columbia Gramophone and The Gramophone Company. Before and during the Second World War, EMI controlled most of the European music market. Having said that, the best was yet to come for EMI, when in the 1960s it shaped music for generations by signing The Beatles. On a business side, two decades later EMI merged with Thorn Electric Industries. EMI also kept increasing its profits and turnover through a series of acquisitions, including the purchase of numerous music publishing catalogues and the four biggest independent record companies at the time: Chrysalis, Virgin, Island and

³³⁸ On 24 November 2003 Warner was acquired by Edgar Bronfman, a former CEO of the Seagram group, the company, who previously sold Universal to Vivendi. David D. Kirkpatrick and Andrew Sorkin, "Warner Music Is Sold: Edgar Bronfman Jr. Is Looking for a Hit," *International Herald Tribune*, November 25, 2003.

³³⁹ For more on the evolution of EMI see Peter Martland, *EMI: The First 100 Years* (London: Batsford, 1997) and Bishop, *supra*, n. 237, at pp. 451 – 452.

A&M, raising their combined market share in the 1990s from 29 to 45 percent. In 1996 EMI de-merged from Thorn and since then has been involved in numerous talks about a new merger with Warner. However, in August 2007 a private equity group, Terra Firma, acquired EMI.³⁴⁰

In addition to the majors, there are a large number of independent record labels, which in the digital age have become more prominent and numerous. Before moving into the discussion of competition law, it is necessary to analyse what makes independent labels so different from majors in terms of their cultural impact.

3.2.2. Characteristics of Independent Music Labels

Whilst the history of independents and their role with regards to the new musical genres was dealt with earlier in this chapter, this particular section discusses the nuances of independent labels, what makes them so different from majors, and how these differences impact upon cultural diversity.

Independents, which are much smaller than the majors, have widely differing characteristics but usually specialise in a certain style of music. Independent companies often sub-contract tasks that would normally be undertaken in-house by a major. As discussed in Chapter 1, in the post-Fordist era, the majority of firms outsource most of their tasks. However, whilst majors outsource creative tasks, independents sub-contract non-creative tasks, for example, manufacturing and distribution of records. Thus, they do not normally have the power to carry out their own distribution to wholesalers and retailers. Overseas exploitation of independents' records is normally carried out by one of the majors although some independents, particularly those operating in niche areas, may license to other independents, or sell records via local distributors, or export the finished product.

Independence as such is an ambiguous concept, particularly in the record industry, because there are so many different labels that consider themselves independent but

³⁴⁰ Danny Forston, "Terra Firma Seal Takeover of EMI," *The Independent*, August 02, 2007; Siobhan Kennedy and Rhys Blakely, "Hands Clinches EMI Deal with 90% Shareholder Support," *The Times*, August 02, 2007.

have licensing, distribution and financial deals with majors. Even both EMI and Warner have recently referred to themselves as independent,³⁴¹ perhaps meaning that they are unaffiliated with any other corporation. Indeed, the definition of an independent label is not an easy one. As indicated in the methodology, interviews were partly aimed at assessing what is the notion of independence in the record industry these days. The interviewees were asked to define what independence meant to them, with response categories ranging from “being able to do what we want to do without reference to anybody else’s agenda”,³⁴² through “long-standing life-time wish to be independent enough to make my own decisions about which records I make and not to have to be crawling cap in hand to a record company 25 year old A&R man who does not even know what he is talking about”.³⁴³ The notion of independence is also closely intertwined with the motivation for setting up music labels. The reasons for starting independent labels are manifold. Some labels are set up because the owners want to make money (not the classical indie notion³⁴⁴), others are set up because no major would release the music of a particular artist or of a particular genre, and others are set up by music altruists who want to bring the music they love to the public. Some simply believe in doing things in a different way.

This, in turn, begs a question of what is a true independent label and how independent are independent labels? By no means, is it an easy question to answer. The definition of the word ‘independent’ is “not under the control or authority of others, and not relying on others for financial support”.³⁴⁵ In terms of the record industry, some are adamant that a true independent label is a homegrown, self-distributed and self-sufficient label,³⁴⁶ whilst others are of the opinion that there is nothing wrong with having a distribution or a licensing deal with a major record company because independents cannot make it on their own due to the lack of the huge distribution networks that only the majors have at their disposal.³⁴⁷ Moreover, the process of acquisitions of independent labels led to the blurring of the notion of independence, as has been rightly noted by Dowd, “the majors allowed pseudo-independents to operate

³⁴¹ See for example, the press release “Major and Independent Record Labels Unveil Dual Disc to Retailers,” August 24, 2004, <http://www.dualdisc.com/press-content01.html>.

³⁴² Interview with Janine Irons, 25 October 2007.

³⁴³ Interview with Mike Batt, 09 July 2007.

³⁴⁴ A classical independent is self-sufficient and does not aim to sell out to a major.

³⁴⁵ Mairi Robinson, *Chambers 21st Century Dictionary* (Edinburgh: Larousse, 1996).

³⁴⁶ Interview with Neil Leyton, 20 March 2006.

³⁴⁷ Interview with Adjei Amaning, 26 June 2007.

within their respective firms”.³⁴⁸ Perhaps Time Warner provides one of the best examples of this when it controlled over 75 labels in the late 1980s and 1990s.³⁴⁹ The above illustrates the fact that the definition of an independent label has changed since the 1950s. In those days a label was independent if a major had not distributed it. Nowadays, most of the independent distribution systems are actually owned by majors (see the discussion below). That explains why some commentators suggested that there should no longer be a division between majors and independents.³⁵⁰ Others however, are not so categorical.³⁵¹ The founder of Rough Trade, Geoff Travis, suggested that an independent label these days is the one that is completely separate from major label finance,³⁵² but at the same time emphasising that an independent label in itself is not a virtue. There are independent labels that release poor quality content too. In this sense, a classic independent is the one that marries its structure with the content.³⁵³ Independents, in terms of this study, represent an economic disconnection from majors that give them the freedom to introduce a diversity of genres to the recorded music market. Perhaps the classification of independent labels below allows the reader to see how hazy the notion of an independent label is.

3.2.2.A. Independent Record Labels: A Wide Spectrum of Structures

As indicated in the above discourse, the independent sector is far from being homogenous. Depending on their market activity, size of roster, work force and sales profits, the labels can be divided into three categories: large, medium and small-sized independents. To date, there has been no attempt to classify independent labels, partly because there are so many of them, and all of them are so diverse in their business strategies. In addition, for the reasons described above, the notion of what an independent label is nowadays is more blurred. Nevertheless, in terms of *size* (meaning sales and structures) independents can be divided into:

³⁴⁸ Dowd, *supra*, n. 128, at p. 7.

³⁴⁹ Album Network, *The Yellow Pages of Rock* (Burbank, CA: The Album Network, 1994). Also cited *id.*, at p. 8. Similarly to this, PolyGram in the UK had financial interest in 82 labels at the end of 1990. Negus, *supra*, n. 284, at p. 18.

³⁵⁰ Negus refers to such interdependence between majors and independents as ‘webs of majors and minors’. See Negus, *supra*, n. 56, at pp. 16 - 18 and *supra*, n. 284, at pp. 17 - 19.

³⁵¹ David Hesmondhalgh, “The British Dance Music Industry: A Case Study of Independent Cultural Production.” *The British Journal of Sociology* 49, no. 2 (1998): 243.

³⁵² Interview with Geoff Travis, 20 June 2007. See also Chris Mugan, “A Bit of Rough and Tumble: Rough Trade Celebrates 30 Glorious Years,” *The Independent*, November 24, 2008.

³⁵³ Interview with Geoff Travis, *id.*

1. Small-sized labels.
2. Medium-sized labels (such as Dramatico and Domino).
3. Large-sized labels, or a hybrid between an independent and a major (such as Beggars Group, Ministry of Sound, and Sanctuary as it was formerly).

However, within the above classification, there could be another breakdown of independents. In terms of the motivation and organisational structure,³⁵⁴ independents can also be divided into following five categories:

1. ‘Classical’ indies, i.e. those that do not sell to a major, and have their distribution deals with independent distributors only, e.g. Jello Biafra, and labels like Kill Rock Stars, Fading Ways Records, Skinny Dog Records, FDM Records³⁵⁵ and extremely successful punk label, Epitaph Records. These labels put creativity and independence as their priority. Mostly, they specialise in indie, rock, punk, and other alternative genres.
2. A label that has been set up because no major would initially release the material, e.g. SubPop Records (which had Nirvana and other big name grunge artists on its roster). However, if the act then proves successful, some kind of financial, licensing or distribution deal is often agreed with a major, including the full acquisition.
3. Simplyred.com model,³⁵⁶ Marillion,³⁵⁷ Radiohead³⁵⁸ – when a hugely successful artist with a stable fan base wants to leave a major record company to make the most of his/her albums’ sales and retain the ownership of their master recordings.³⁵⁹ The presence of this type of label increases in the digital age

³⁵⁴ Organisational structure is very important in relation to diversity, and is often neglected by the economists. Christianen, *supra*, n. 125, at pp. 86, 89.

³⁵⁵ In the words of Kieron Concannon, manager of FDM Records: “When we set up the label, we vowed never to work with the majors. They have destroyed the industry with their greed and short-termism. This current dependence on reality TV is just another blow to an industry that probably wouldn’t be able to give U2 enough support to make it if they were starting up now”. Also cited in David Sinclair, “Independent Music: There’s a Musical Revolution Going On,” *The Independent*, February 3, 2006.

³⁵⁶ Sathnam Sanghera, “Hucknall,” *The Financial Times*, March 25, 2003.

³⁵⁷ Nigel Jopson, “There Is also a Third Way,” *Resolution Magazine* (May/June 2003): 52.

³⁵⁸ Jonathan Brown, “Radiohead Album Goes Live on the Internet,” *The Independent*, October 11, 2007.

³⁵⁹ Sinclair, *supra*, n. 355. See the glossary for the definition of master recordings.

because once the artists have a stable fan-base; it is easier for them to sell their records without the support of the majors.

4. Dramatico model – when an entrepreneur or producer finds a person to suit his project and sets up a label to release that artist and make the most of the profits.
5. Sanctuary model – when an independent label wants to grow, and in some way these labels become too big to be small (because they are considered like majors for small independents), and too small to be big (because they are still too small to compete with majors on equal terms).

The most common is perhaps the second category of independent labels followed by the classic independents' category. The remaining three categories are more an exception to the rule; however, they are becoming more prevalent in the digital age. At this point, it is important to note that the vast majority of labels, including the ideologically motivated ones, aim to sell their music and to make a profit. This profit-making issue does not present a hurdle in answering the research question because the importance of competitive small businesses in an economy should not be underestimated (discussed below in Section 3.5).

Normally, the majors provide financial resources, marketing and distribution expertise while the independents provide A&R expertise, thus often being the source of innovation in the market. For instance, 'punk', 'heavy metal', 'hip-hop', 'jazz', 'rhythm and blues', 'glam-rock' and 'house' genres were all developed by the independent sector and then embraced by the majors.³⁶⁰ As exemplified above, majors often move to compete in a new market sector by developing similar artists or content. Alternatively, they may seek to acquire an independent and retain it as a separate label to take advantage of its reputation in the market. It seems valid to say that majors are using independents as their *A&R*, but it can also be argued that as independents do not have the money to take it to the level that majors can, they nurture and release new artists and genres and then use the majors as the *distribution, marketing* and *promotional* tool instead. It must be noted though that the majority of the independents have little or no contact with majors and use independent recording studios,

³⁶⁰ For more details see Gander and Rieple, *supra*, n. 121, at pp. 249-250.

manufacturers, and distributors. The distribution issue itself is not a clear-cut one. In the 1970s – 80s, there was a huge wave of vertical acquisitions, i.e. when majors bought up almost all of the independent distributors.³⁶¹ However within the past decade, there appeared a new wave of independent distributors, some of which are owned by majors, and small labels prefer to deal with them because “with major distributors we (independents) are just a number in the catalogue, whereas independent distributors give us personal treatment, we are prioritised”.³⁶²

The fact that the majority of independent labels have no relation with majors can be explained in a number of ways. It may be because independents’ current volume of sales and their growth potential are too small to interest the majors, e.g. Vanquish Records. It could be the result of the choice of niche market served, e.g. Dune Records. Alternatively, it might be that company finances are sufficiently stable to avoid relying on an outside agent, e.g. Dramatico. Some company owners may be ideologically opposed to the idea of affiliating to a major, e.g. Fading Ways Records. The independent status of a label should not be under-estimated as it may be a statement of principle; or it may also serve as an aid to marketing a particular character in such a way as to attract artists and fans (see the example with Oasis below, page 109). For example, it is difficult to imagine the Arctic Monkeys on a major’s roster. As the recent news headlines demonstrated,³⁶³ there is a trend amongst artists to prefer to sign with a particular independent even when in receipt of offers from one or more of the majors.³⁶⁴ This has been recently witnessed by the deals between independent labels and groups like Enter Shikari, Arctic Monkeys and Franz Ferdinand. Even though they could arguably obtain terms that are more preferable with majors, they chose to sign with small independent labels.

In this respect it is interesting to find out what makes these new successful bands and artists sign with relatively small labels in preference to the multi-million pound record deals with majors. The discussion below takes the reader through the most salient differences between majors and independents including culture, resources and capabilities.

³⁶¹ Alexander, *supra*, n. 172, at p. 92.

³⁶² Interview with Neil Leyton, *supra*, n. 346.

³⁶³ Chris Mugan, “Shikari: A Record Deal? No Way,” *The Independent*, 19 January 2007.

³⁶⁴ Jude Rogers, “The Labels that Turned the Tables,” *The Guardian*, September 12, 2008.

3.3. Differences in Approaches between Majors and Independents

“At Warners, I got the biggest shock when I first sat in a budget meeting with spreadsheets... We never had spreadsheets at Stiff. We never had budgets.”³⁶⁵

Paul Conroy

“What I am looking for is to develop software applications that can differentiate our products and then use *content* as a *sledgehammer* to sell them.”³⁶⁶

Sir Howard Stringer

In order to understand the differences between the two types of record labels, it is necessary to look at their cultural significance, which in turn necessitates analysing the effect of the size of the labels and economies of scale on diversity. Following that, looking at the innovation patterns and the cultivation of niche markets, a willingness to take more risks by the small business and the organisational culture also helps make the case for the importance of independent labels.

a) **Size** is the most obvious difference between the two types of companies. Majors can afford to have their own manufacturing and distribution facilities as well as fund very expensive promotional campaigns. By contrast, the vast majority of independents outsource both manufacturing and distribution, plus they cannot afford a costly marketing campaign. The record industry is a sunk cost industry.³⁶⁷ Therefore, the risks of not being able to recoup costs for a small company are considerable at the initial stages when investing in new artists. The infamous ‘9:1 ratio’ in the record industry means that only 1 act out of 10 will be successful enough to pay for the 9 ‘failures’.³⁶⁸ Majors, due to their size and access to finance, can cope with this situation better than the independents. They can spread their risks for particular records they release, because although they do not know in advance whether a particular artist will sell a few hundred or several million copies of their record, they have enough artists on their roster

³⁶⁵ Quoting Paul Conroy, ex-manager of Stiff Records who later moved to Warner, Chrysalis and Virgin. Also cited in Tim Cooper, “Pop: Finger on the Pulse,” *The Sunday Times*, September 03, 2006.

³⁶⁶ Quoting Sir Howard Stringer, CEO of Sony. Also cited in Michiyo Nakamoto and David Pilling, “Sony Chief Embraces ‘Sledgehammer’ Strategy,” *The Financial Times*, September 25, 2005.

³⁶⁷ See the glossary for the definition of ‘sunk cost industry’.

³⁶⁸ Alexander Belifante and Richard L. Johnson, “Competition, Pricing and Concentration in the U.S. Recorded Music Industry.” *Journal of Cultural Economics* 6 (1982): 14.

to ensure that they receive a reasonably predictable flow of income overall. The small company, by contrast, sometimes with only one or two artists, cannot afford a ‘mistake’ like that³⁶⁹ (see the discussion below as regards innovation v. commerce). The two types of companies in turn, intrinsically connect this fact to the way artists are treated. If an artist sells less than 300,000 copies on a major record company, he/she is likely to be ‘dropped’ by the label.³⁷⁰ This economy of scale dictates that a major will only be able to cover its costs upon the sale of 300,000 copies. Any sales crossing that amount will go on to make the record profitable. Such a high threshold means that majors normally do not allow artists to develop their careers with them if the first album has not sold over the required threshold. This situation can hardly be described as advantageous to an artist because the latter only has one career³⁷¹ and they do not have hit records from day one. By contrast, independents do not need such a high threshold to make a profit as discussed next.

b) Economics of Scale is another salient feature, which is intrinsically connected with the size and homogeneity of products, since the greater the economies of scale, the more homogenous cultural products are released in the market.³⁷² Independents tend to be much more niche in the way that they market music. Normally, an independent can make a profit out of a record that sells 20,000 copies and they usually operate on the profit sharing model.³⁷³ This should be seen, in contrast, to the major’s threshold of 300,000 copies. Thus the scenario can be described as one of major companies for major artists (superstars), as in those artists who can guarantee good profits.³⁷⁴ If an artist is on a major label, he or she must be aimed at the mass market as opposed to the niche market, whereas independents predominantly cater for the niche markets.

³⁶⁹ Conal Walsh, “Size Does Matter. It’s Good to be Small,” *The Observer*, June 22, 2003.

³⁷⁰ Interview with Keith Harris, 6 September 2007. There maybe exceptions to this rule, however this figure came up in conversations with several A&R people and at numerous music industry panels.

³⁷¹ Interview with Mike Batt, *supra*, n. 343.

³⁷² The same interdependence between economy of scale and homogeneity was found in other cultural industries: the TV and newspapers. See Doyle, *supra*, n. 178, at pp. 8, 11, 22.

³⁷³ McLeod, *supra*, n. 200, at p. 527.

³⁷⁴ For example SonyBMG’s Burgundy Records focuses *only* on the stars like Chaka Khan, Gloria Estefan and Donna Summer, i.e. those who have already enjoyed ‘platinum’ status in the past and can guarantee steady sales. Louis Hau, “Old Stars, New Music, New Money,” *Forbes*, June 26, 2007; Eric Strobl and Clive Tucker, “The Dynamics of Chart Success in the UK Pre-Recorded Popular Music Industry,” *Journal of Cultural Economics* 24 (2000): 116. Sanctuary Records used a similar model of signing established artists who have been jettisoned by major record companies, but this was an exception to the rule.

Major labels operate much more on their ‘advances’³⁷⁵ culture, which means that artists are charged for the costs and expenses of making their albums. Throughout their history, majors offered artists big up-front money and big investment although this system is changing now because even majors cannot afford such high payments anymore.³⁷⁶ Independents could never afford such amounts so as a result they deal with artists differently. In order to attract people to whom independents are paying such small amounts of money, one has to have some kind of partnership with that performer, whilst with a major label, “it is very much a master and a servant relationship; they expect a service from you”,³⁷⁷ and quite often the major selects the material for the album. With a major record company, there is more of a production line effect: the record is released, there is a small window of opportunity, all marketing goes into that window of opportunity and if the record is not successful, an artist is dropped by the label.³⁷⁸ By contrast, independents normally give their artists a second chance because the relationship is more of a partnership between label and artist.³⁷⁹

c) Innovation v. Commerce and the resulting tension – it has almost become a cliché that majors have done well for commerce, whilst independents have done well for innovation. To this date, this has remained unchallenged. Hence, the explanation below seeks to address this dilemma.

Some music industry insiders have expressed their anger with majors’ short-term approach to culture, which could be described as “the next quarter results that should be presented to shareholders”.³⁸⁰ This short-term approach dismisses the fact that art needs a longer term to develop.³⁸¹ Some echo similar concerns that a major will sign an artist not necessarily because of the artist’s talent: it is rather “a selection made according to a whole series of commercial judgments and cultural assumptions”.³⁸² However, such tactics can be argued to be beneficial to independents because the latter fill the vacuum in the music market, but at the same time, such tactics may impact negatively on the

³⁷⁵ See the glossary for the definition of ‘advance’.

³⁷⁶ Sabbagh, *supra*, n. 317.

³⁷⁷ Confidential source.

³⁷⁸ Interview with Keith Harris, *supra*, n. 370.

³⁷⁹ Dorian Lynskey, “They Put Out Records the Way You Want Them Put Out,” *The Guardian*, October 30, 2003.

³⁸⁰ This point of view prevails because majors are public companies and have to account for their actions before shareholders.

³⁸¹ Quoting Pete Jenner, MusicTank seminar, *supra*, n. 323.

³⁸² Negus, *supra*, n. 56, at p. 32.

artists and, consequently the consumers. As expressed by one interviewee: “every time I have had a big success it is when a (major) record company had given up on me, be it Wombles, or Bright Eyes. These things have never been on a priority list and if you are not there, forget about everything”.³⁸³

Contrary to that, one could advance the argument that it is actually independents who do not care about cultural diversity or innovation because all they care about is how not to make a ‘flop’ record and lose everything. Therefore, the argument could be that independents in the digital age are geared more towards making hits, than not, with profit making being the first thing on the independents’ agenda. As this seems to be a valid argument, most of the interviewees were confronted with it. Janine Irons, an owner of a small independent jazz label, gave an interesting response:

“That is a good argument. In the jazz world, I can definitely say that it is not about the money (laughs). It is about cultural and artistic things. We can only release one or two albums a year because we only have the personnel to deal with that number of recordings. We only have the money to support a release properly by limiting the number of the recordings that we do. Majors may release more records but I do not know if they are diverse.”³⁸⁴

And whilst Bobby Colomby noted: “big or small, it does not matter, everybody is in the business of making money”, he also admitted that “little labels are visionaries”.³⁸⁵ In my view, the argument as to whether independents too are in the business of profit making is best illustrated by the following response from an independent label founder and owner:

“The quantity of money that a major makes is different from the quantity of money that an independent label makes. It is about making money even for independents. But I am an artist. If one asked me what would you give up: ‘a record label or being an artist’? The answer would be: ‘I would give up a label’. Whereas if one went to the Head of Universal and asked the same question, his answer would be to give up being an artist because he is not an artist. I am driven as an artist. I can relate to my artists. If I say something on an artistic level, they know I care because I am an artist and I know what it is like to be bossed around by a record company”.³⁸⁶

³⁸³ Interview with Mike Batt, *supra*, n. 343. For further examples of perseverance by independent labels see Jeff Howe, “No Suit Required,” *Wired*, August 25, 2006.

³⁸⁴ Interview with Janine Irons, *supra*, n. 342.

³⁸⁵ Interview with Bobby Colomby, *supra*, n. 297.

³⁸⁶ Interview with Mike Batt, *supra*, n. 343.

As has been noted above, some of the independents work in particular niche markets,³⁸⁷ where the majors do not compete so strongly, and many concentrate on innovative or ‘alternative’ music, which sometimes leads to the establishment of a new fashion in musical taste that the majors are then anxious to emulate. Once majors know what kind of music consumers seem to want, they supply more of the same. Big companies need big sales. However, it would be *incorrect* to say that majors do not care about cultural diversity. Indeed, it is not always the case that independent labels are good and major labels are bad. It would be wrong to dismiss all Hollywood films as bad ones just because they are made in Hollywood. It seems that independents are not set out to care more about cultural diversity than majors; but they have more of an *effect* on cultural diversity.³⁸⁸ Due to the fact that majors are multi-national corporations, they operate on a global basis. Even though majors sign artists performing in different genres, they are predominantly interested in superstars to keep their company in existence. Independents, on the contrary, tend to be regional. As a result they champion the music they find locally and champion the local markets. Hence, they have much more of an effect on cultural diversity than the majors.

An independent label brings to the market something unique because the artists developed by independents are different from the artists developed by majors. As explained before, a major does not tend to have the relationship with the artist (unless the artist is a superstar)³⁸⁹ that an independent label has. An ‘indie’ label will normally bring to the market a creative talent that is not already there because a major will be too scared to take that risk. There are countless examples of this, for example The Cure who were originally signed to Fiction, another legendary independent label at the time, or artists that Stiff Records signed, one of which was Elvis Costello.³⁹⁰ They were very different from the ones developed on majors’ rosters. As was argued by Safta Jaffery who discovered Muse and signed them to his label:

³⁸⁷ The problem with niches is that they mean the exclusion of other genres, thus potentially stifling cultural diversity. However, the diversity in terms of this study means the diversity of the products in the entire sector, not within each producer’s owned sector. Therefore, niche does not mean that there is no diversity. What is more important is the diversity of producers because they have many niche products in the market rather than a single large producer that releases different types of music.

³⁸⁸ Interview with Keith Harris, *supra*, n. 370.

³⁸⁹ Even superstars like Paul McCartney left majors because in his case EMI did not establish a relationship with him. Sabbagh, *supra*, n 317.

³⁹⁰ Fiction Records was set up in 1991 and bought up by Polydor in 2004.

“If you look at my experience with Muse, when I first took them into the market, nobody wanted them because they were a huge risk. Majors told me that Muse did not write commercial songs that will work on radio. I knew they were not commercial but I knew that they were an extraordinary talent. Had I signed Muse to a major label, they probably would not have been the success they are today. The reason why they are a success story today is because we persevered for 6 years from the independent label point of view. Now they are one of the greatest bands in the world.”³⁹¹

The diversity of majors is of a different kind; it is a controlled diversity. Major record companies in particular guide ‘creativity’ so that music (and videos) are recognisable but in a *slightly* different way; therefore, the industry then has a direct impact “on how creativity can be realised”.³⁹² An interesting example can be illustrated with the case of jazz music. Two of the interviewees pointed out that jazz was of no interest to record companies. These days jazz to a major is Norah Jones, Michael Bublé, and Diana Krall,³⁹³ which show that majors are interested only in ‘crossover’ potential. Another interviewee noted that majors have not been working with any young jazz musicians, and as such no new talent was coming through in the jazz scene.³⁹⁴ That is why an outlet for jazz musicians is needed in the form of an independent label.³⁹⁵

Bearing in mind the previous discussion, it can be concluded that one of the main differences between majors and independents is that the former start with a market demand to which an artist must tailor, whilst the latter start with an artist and their inspiration. Majors *cater* for the markets, whilst independents *create* the market; hence the latter are crucially important in terms of cultural diversity. This is important to bear in mind for the future discussion about record industry consolidation.

d) Culture v. Corporatism – it is also important to distinguish what drives people to set up their labels, and how much the notion of independence matters. Overall the interviews conducted produced a predominantly similar answer on this issue: “the reason people set up their labels was to create their own environment, something they liked and enjoyed - they were trying to create community. Independents care about the way they work; the work culture is very important”.³⁹⁶ Almost all interviewees

³⁹¹ Interview with Safta Jaffery, 21 June 2007.

³⁹² Negus, *supra*, n. 32, at p. 359.

³⁹³ Interview with Bobby Colomby, *supra*, n. 297.

³⁹⁴ Interview with Janine Irons, *supra*, n. 342.

³⁹⁵ For a more detailed account see Sholto Byrnes, “Jazz: The Best New Stuff Thrives far from the Majors,” *The Independent*, February 3, 2006.

³⁹⁶ Interview with Geoff Travis, *supra*, n. 352.

concurred that they wanted to create their own work environment and escape the politics and bureaucracy of majors. In the opinion of Adjei Amaning:

“I worked for majors and independents and I never ever felt part of the major. I felt I was doing a job. When I was working for Sanctuary it felt that I was part of something. For me what was important is that I wanted to create an environment where people felt part of something”.³⁹⁷

One of the other main differences in culture between majors and independents is that the former, particularly these days, are predominantly run by executives who have either little or no experience of the record industry, whereas the latter are generally run and staffed by passionate music lovers.³⁹⁸ This, in turn, leads to culture tensions within companies.³⁹⁹ In addition to that, there is also evidence of hostile relationships between a major company and its acquired imprint label⁴⁰⁰ (examined in depth in Chapter 4).

The cachet of the label is also very important to the artists.⁴⁰¹ Labels like Rough Trade, Factory Records, Motown, Domino,⁴⁰² or Stiff Records have all possessed this cachet, and it can be argued that the artists from those labels built their careers on cultural capital.⁴⁰³ The same cannot be said about majors, with the slight exception of EMI. Three decades ago Warner used to be a great company in terms of their cachet when they had artists like Van Morrison, Joni Mitchell, Neil Young, Grateful Dead, and Randy Newman, but since then it has changed. These days, after the departure of

³⁹⁷ Interview with Adjei Amaning, *supra*, n. 347.

³⁹⁸ For example, three new executives at EMI under the Terra Firma have no experience of the record industry. They come from finance, chemicals company and management background. The A&R staff has also been replaced by ‘suits’ at Sony and Vivendi. See James Hall, “Terra Firma Brings EMI Down to Earth,” *The Telegraph*, September 02, 2007. There is, of course, always an exception to the rule with Andy Taylor, the founder of Sanctuary Records, formerly the largest independent music company in the UK, who was a chartered accountant. Jason Nisse, “The Lowdown: Sex’n’Suits and Rock’n’Roll...and Strokes of Genius,” *The Independent*, October 26, 2003.

³⁹⁹ Negus, *supra*, n. 56, at pp. 64-82.

⁴⁰⁰ *id.*

⁴⁰¹ Rob Sharp and Rebecca Armstrong, “Record Labels that Rocked Our World,” *The Independent*, January 17, 2008.

⁴⁰² Alastair McKay, “Record Labels: The Domino Effect,” *The Independent*, February 3, 2006.

⁴⁰³ The term ‘cultural capital’ was invented by Pierre Bourdieu in 1973. See Richard Jenkins, *Pierre Bourdieu* (London: Routledge, 2002), 128 – 152 and Theodore Gracyk, *I Wanna Be Me* (Philadelphia: Temple University Press, 2001), 33. For more on the importance of cultural capital for the independent labels see Sarah Thorton, *Club Cultures: Music, Media and Subcultural Capital* (Middletown CT: Wesleyan University Press, 1996); Rob Young, *Rough Trade: Labels Unlimited* (London: Black Dog Publishing, 2006); *The Independent*, “Rough Trade: the Label that Changed Music History,” September 08, 2006; and *The Independent*, “Rough Trade: Rough and Ready,” September 10, 2006.

Madonna,⁴⁰⁴ Warner still has REM and Red Hot Chilli Peppers on its roster, but it can hardly be said to have any cultural cachet any more.⁴⁰⁵

The anti-corporate ethos and message of genres like rock, punk, and rap is still important and prevalent. Oasis provides a salient example of how crucial the indie credentials and cultural capital can be in terms of anti-corporate attitude (and political reasons).⁴⁰⁶ Oasis was discovered by Alan McGee and was signed to his then independent label, Creation Records. Although what the consumers did not know was that Creation had a hidden financial deal with Sony to market Oasis, since it would be disastrous for Oasis to be associated with Sony while promoting 'Cool Britannia'. The importance of cultural integrity can be further demonstrated by the American indie-rock group, Band of Horses, which had to recall the song they had licensed to Wal-Mart's online campaign in 2007 after a fan backlash.⁴⁰⁷ A further example is the Smashing Pumpkins who sued Virgin Records for using their music in Pepsi and Amazon commercials claiming that Virgin's actions threatened their reputation for artistic integrity.⁴⁰⁸ This shows that the symbolic notion of being associated with an independent label and cultural capital can be crucial, and in present times, this notion has gained more importance with artists like Arctic Monkeys, Kaiser Chiefs, Franz Ferdinand all signing to independent labels.

Apart from the work culture and cultural cachet, in terms of business methods it is also much more difficult for a major label to change the way in which it operates. Because of the majors' inflexibility, they have missed out on a vast number of opportunities that could help them escape the market slides. The business method of majors and independents can be described as "a big ship v. a speed boat argument".⁴⁰⁹ For a major label to change, it takes so many departments, quite often in several territories, to approve a certain decision. With an independent label, however, mostly it is a case of a

⁴⁰⁴ Ray Waddell, "Madonna Confirms Deal with Live Nation," *The Billboard*, October 16, 2007; and Brian Garrity, "WMG Downplays Madonna's Exit," *The New York Post*, October 17, 2007.

⁴⁰⁵ Interview with Geoff Travis, *supra*, n. 352.

⁴⁰⁶ For a good account of the events see David Cavanagh, *The Creation Records Story: My Magpie Eyes Are Hungry for the Prize* (London: Virgin Books, 2000).

⁴⁰⁷ Daniel Kreps, "Band of Horses Retain Ownership of their Soul, Turn Down Wal-Mart Commercial," *The Rolling Stone*, November 16, 2007.

⁴⁰⁸ Owen Gibson, "Smashing Pumpkins Sue Record Label over Use of Songs in Pepsi Promotional Deals," *The Guardian*, March 26, 2008; *ABC News*, "Smashing Pumpkins Sue Virgin Records," March 25, 2008; and Jonathan Cothen, "Smashing Pumpkins Lawsuit Latest Step in Feud," *The Reuters*, March 27, 2008. For more on cultural credibility in music see Jeff Leeds, "Does This Latte Have a Funny Mainstream Taste to You?" *The New York Times*, March 17, 2008.

⁴⁰⁹ Interview with Keith Harris, *supra*, n. 370.

few people meeting at the earliest opportunity to approve and make the necessary changes regarding, for example, the label's direction or an artist's career.

The biggest downside of the small-sized label is that it may be disadvantaged in terms of lacking the finance to market a certain record.⁴¹⁰ The lack of knowledge of how to run a label and how to finance that label's operations is by far the biggest problem for the independent sector.⁴¹¹ However, if an independent label is successful, the benefits of a small-sized company reflect positively on the artists. For example, as one interviewee noted: "... we (Dramatico) have 1 artist and 3 marketing people. Universal in London have about 100 artists, and I do not think they have 300 marketing people to attend to those artists".⁴¹²

The lack of finance⁴¹³ and over-expansion⁴¹⁴ are closely connected with the controversial issue of a 'sell-out' by independent labels. As the research question aims to answer whether competition law should provide special protection for the small business in cultural industries, the sell-out may be a cornerstone in justifying such special protection for small companies whose long-term ambitions could be to sell out for a substantial amount of money. As the discussion below demonstrates, this issue is not a straightforward one, and it may be connected with the high level of consolidation in the record industry.

⁴¹⁰ See *The Independent*, "Stiff Records: If It ain't Stiff, It ain't Worth a Debt," September 15, 2006.

Likewise, Factory Records achieved a 1.5 percent singles market share in 1990, but it nevertheless was bankrupt by 1992. See Hesmondhalgh, *supra*, n. 31, at p. 477. For the full account of the financial difficulties faced by the independents see also Nicholas Wilson *et al.*, *Banking on a Hit: The Funding Dilemma for Britain's Music Business* (Kingston University for the Department for Culture, Media and Sport, October 10, 2001).

⁴¹¹ This lack of knowledge is being mended by numerous mentoring events organised by the Association of Independent Music and other trade bodies.

⁴¹² Interview with Mike Batt, *supra*, n. 343.

⁴¹³ Tim Cooper, "Pop: Finger on the Pulse," *The Sunday Times*, September 03, 2006.

⁴¹⁴ The history of a legendary independent label, Sanctuary, showed that sometimes an independent label can grow too fast to face its own demise. At the moment of writing, Sanctuary is part of Universal Music Group. See Andrew Edgecliff-Johnson, "Urban Woes Have Sanctuary Singing the Blues," *The Financial Times*, September 24, 2005; Dan Sabbagh, "Sanctuary Braced for Painful Hit," *The Times*, October 31, 2005; Cossima Marriner, "Pop Goes the Label," *The Guardian*, August 24, 2005; Conal Walsh, "Heaven Knows British Music Bastion is Miserable Now," *The Observer*, August 7, 2005, and *The Guardian*, "You Just Haven't Earned it Yet, Baby," August 24, 2005.

3.4. The Blurring of Independent Labels: The Reasons for Selling Out

As has been demonstrated by the evolution of majors, they have historically grown in size usually as a result of mergers and acquisitions, whereas independent labels have grown larger by developing a successful roster of artists and achieving an international presence by operating in different territories or by licensing their recordings to overseas record companies. There have been some huge success stories amongst independents like Virgin, Island, A&M, Zomba and Chrysalis. They all started as small independents specialising in particular niche genres of music but were successful in developing into significant businesses with extensive rosters of artists covering a wide range of musical styles. Their stars included U2, Bob Marley, Frankie Goes to Hollywood (Island), Miles Davis (Blue Note), Cream, the Bee Gees, Led Zeppelin (Atlantic), Police and Sting (A&M), Nirvana (Sub Pop), the Jackson 5, Diana Ross, the Supremes, Stevie Wonder (Motown), Boy George, Mike Oldfield, the Sex Pistols, Genesis, Culture Club and Simple Minds (Virgin), N*SYNC (Zomba) and Sinead O'Connor (Chrysalis). These companies had records suitable for global sales and achieved a prominent position in the market. This is one of the reasons why they were subsequently sold to majors. There is also a myriad of much smaller labels that have sold out to majors, which in turn makes it more difficult to argue for an ethic of independence. Whilst it was illustrated earlier on in this section that traditionally the independents have their own ethos and stand for different values than majors, at a certain point contradiction arises when some independents sell out to a major. Therefore, it is necessary to see what drives independents towards the sell-out.

As this thesis explores the issue of the protection of cultural industries by competition law, a question arises as to *why* competition law should protect small labels, when *some* of them, deep down, wish to sell out, eventually, to a bigger company. This is an important point that necessitates an explanation. In 2006 Pete Waterman, a famous producer from Stock, Aitken and Waterman, wrote an article titled *Sympathy for the Devil*,⁴¹⁵ with the devil being the independent sector. Interestingly, the article itself did not provoke much response, but nevertheless it contained some interesting points regarding the hypocrisy of independent labels in their opposing of mergers at the EU level, bearing in mind that they themselves would like to grow in size (this issue is

⁴¹⁵ Pete Waterman, "Sympathy for the Devil?" *The Wall Street Journal (Europe)*, November 16, 2006.

addressed in Chapter 4). The article also emphasised that independent labels are as much in the business of making money, as are the majors. In order to question the hypocrisy of independents, almost every interviewee was confronted with Pete Waterman's concept. In this respect, it is important to know *why* independents sell out, and more importantly to remember that *not* all independents sell out. With a couple of exceptions, all the interviewees rejected the arguments of Pete Waterman.

It is important to re-emphasise that the majority of the independent labels do not sell out. They compete with the majors for many reasons: the reasons range from those wanting to be idiosyncratic and individualistic to others wanting to remain in control of their freedom and ideas.⁴¹⁶ In the words of Neil Leyton:

"I don't criticise those who sell their label. Work that goes into an indie comes from the heart. But some people want to move on and again it is a very emotional thing...selling a life's work. I also know a lot of people who would never do that. I am not saying that one is better than the other, it is just different people".⁴¹⁷

However, if an artist's career develops successfully, the independent may not have the financial resources to fund the promotion and marketing that the artist then requires.⁴¹⁸ As Safta Jaffery, who sold out to Warner in 2005, explained:

"In my case, the more successful we became the more problems we encountered. To be successful in the music marketplace, you have got to have deep pockets. This is where majors always win out because they have huge deep pockets. If an act becomes successful, everything becomes more expensive: the artists get greedier, the videos become more expensive, the production and recording costs go up and everything goes up. And if one is trying to compete to stay in the charts, his / her marketing budget goes through the roof on a weekly basis...one has got to spend what the majors are spending to compete with that".⁴¹⁹

Therefore, business requirements may be one of the reasons for selling out. As it will be discussed later, one positive outcome of the sell-out may be that the founders of labels who sold out to majors have enough funds to set up new labels and discover more talent and support new artists.

⁴¹⁶ Colin Gray, "Managing Entrepreneurial Growth: A Question of Control?" in *Small Firms: Entrepreneurship in the Nineties*, ed. David Deakins *et al.* (London, Paul Chapman, 1997), 23.

⁴¹⁷ Interview with Neil Leyton, *supra*, n. 346.

⁴¹⁸ *The Guardian*, "The High Cost of Selling Out," June 29, 2007.

⁴¹⁹ Interview with Safta Jaffery, *supra*, n. 391.

Having shown how a wide range of differing record companies operate, it is now appropriate to explore *why* competition law should be utilised to protect producer diversity (thus cultural diversity).

3.5. The Justification of Why Competition Law Should Protect Producer Diversity

Chapter 1 partially explained *why* cultural industries overall deserve to be protected by competition law and it also examined the arena of *product* diversity. However, there is also the diversity of *producers* to be considered because a range of various producers is closely linked with differentiated products. In order to show why, if at all, competition law should protect producer diversity in the cultural sector, firstly some definitions and statistics are presented, followed by a discourse into the importance of small businesses in terms of competition and innovation.

3.5.1. Cultural and Economic Importance of Small and Medium-Sized Producers in Cultural Industries

In the EU small and medium-sized enterprises (hereinafter, SMEs) have received a lot of attention within the last two decades from both scholars and governments.⁴²⁰ Having said that, while there is an abundance of EU policy and studies aimed at increasing and protecting the numbers of SMEs, to date there is only a handful of published research that deals directly with SMEs engaged in the *cultural* sector.⁴²¹ This raises concerns that governments lend their support largely for SMEs involved in *manufacturing* businesses and once again the *cultural* aspect is being neglected. The UK Government for example, constantly emphasises the importance of cultural industries in terms of

⁴²⁰ Zoltan J. Acs, *Are Small Firms Important? Their Role and Impact* (Boston: Kluwer, 1999), 1-4. The importance of SMEs has been re-enforced at the European level once again in 2005. See *European Competition Commission*, "EU Envoy Report on the Activities of the European Union for Small and Medium-Sized Enterprises," February, 8, 2005, at pp. 1 – 48.

⁴²¹ See for example, Wilson *et al.*, *supra*, n. 410. Other documents are more policy-orientated, for example, the *European Council*, "First-ever European Strategy for Culture: Contributing to Economic Growth and Intercultural Understanding," May 10, 2007.

GDP and GVA,⁴²² but not much is being done to actually protect the innovative small sector.

SMEs are defined as non-subsidary, independent firms, which employ fewer than a given number of people: less than 250 employees in the EU, and less than 500 in the US.⁴²³ There are two views about the impact of small businesses on economic activity. On the one hand, their scale of production is too small to be perhaps optimal in their cost structures but on the other hand, some have argued, particularly within the past 20 years, for the importance of small businesses to the economy and for their innovative contributions.⁴²⁴ Despite the scholastic differences regarding the significance of SMEs, the facts speak for themselves. Overall, SMEs account for over 95 percent of firms and they play a major role in economic growth by being the source of new jobs (on average, they account for 60-70 percent of employment).⁴²⁵

SMEs play an integral role in market economics renewal processes because of “their experimentation leading to both productivity growth and variety; they are about change and competition because they change the dynamics of market structure”.⁴²⁶ In addition, small businesses afford the opportunity for creative people to enter into economic society; they are ‘the agents of change’⁴²⁷ and ‘the carriers of new ideas’.⁴²⁸ Their contribution to innovation is an important feature. Generally, the level of innovation depends on the type of industry. Pursuant to the Schumpeterian view discussed in Chapter 1, capital intensive industries, such as chemical or car industries, larger firms have the innovative edge, whilst in the record industry it seems that the smaller firms have more freedom to innovate and more opportunities to record their music in the

⁴²² See *supra*, n. 46.

⁴²³ In the European Union, SMEs are the enterprises with an annual turnover of less than EUR 40 million and/or a balance sheet total not exceeding EUR 27 million. See Commission Recommendation 2003/361/EC of May 6, 2003 concerning the definition of micro, small and medium-sized enterprises [2003] OJ L 124, at p. 36 and also *Organisation for Economic Co-operation and Development*, “Small and Medium-sized Enterprises: Local Strength, Global Reach,” June 2000, at p. 2.

⁴²⁴ See for example, Zoltan J. Acs, *The Changing Structure of the U.S. Economy: Lessons from the Steel Industry* (New York: Praeger, 1984).

⁴²⁵ See *Organisation for Economic Co-operation and Development*, *supra*, n. 423, at p. 2. For the importance of SMEs from the employment point of view and their contribution to the economic welfare of the society see David J. Storey, *Understanding the Small Business Sector* (London: Routledge: 1994).

⁴²⁶ Acs, *supra*, n. 420, at p. 3.

⁴²⁷ David B. Audretsch, “Small Firms and Efficiency,” in *Are Small Firms Important? Their Role and Impact*, ed. Zoltan J. Acs (Boston: Kluwer, 1999), 33.

⁴²⁸ Small firms are not necessarily more innovative than larger firms but new firms are often the carriers of new ideas. See Bo Carlsson, “Small Business, Entrepreneurship, and Industrial Dynamics,” in *Are Small Firms Important? Their Role and Impact*, ed. Zoltan J. Acs (Boston: Kluwer, 1999), 106.

digital age. As stated in Chapter 1, small firms are less bureaucratic; they are able to exploit innovations that are too modest or risky for larger companies. Thus their contribution to the economy can be summarised as being key for innovation; a seedbed from which larger businesses can grow and as a complement to large firms in the wider structure.

Small businesses are important in a number of ways. Firstly, in terms of *speed and flexibility* small firms can react and adapt to change much quicker than large ones, particularly so in the record industry and secondly, in terms of *dynamics* small firms provide “the entrepreneurship and diversity required for microeconomic growth and stability”.⁴²⁹

The significance of small firms is best illustrated by the fact that “the *stability* at the macroeconomic level requires a great deal of *instability* (or gales of creative destruction)⁴³⁰ at the microeconomic level”.⁴³¹ In other words, the fact that smaller firms experiment and innovate more, experience seesaw failures and successes and are overall less staid leads to them contributing in a very real way to a dynamic and fluid economy.⁴³² In the absence of diversity, large firms tend to produce similar products and operate in similar ways. To sum up, both large and small firms are important but their roles are different.⁴³³ Both types of firms are needed, as the more firms, the more innovation there is in a market.

In speaking of the record industry’s concrete example, earlier sections of this thesis demonstrated that independent labels are generally more flexible than large integrated record companies. Independent labels in the record industry sense opportunities, innovate, and take risks. Sceptics would argue that the same can be said about the majors but as history demonstrates, the majority of new genres and artists have been discovered by independents and then outsourced by the majors. Moreover,

⁴²⁹ *id.*, at p. 100.

⁴³⁰ The term was introduced by Joseph Schumpeter, *The Theory of Economic Development* (Cambridge Mass: Harvard University Press, 1934).

⁴³¹ See Paul Reynolds, “Creative Destruction: Source or Symptom of Economic Growth?” in *Entrepreneurship, Small and Medium-Sized Enterprises, and the Macroeconomy*, ed. Zoltan J. Acs *et al.* (Cambridge: Cambridge University Press, 1998), 97; Gunnar Eliason, “Micro Heterogeneity of Firms and the Stability of Industrial Growth.” *Journal of Economic Behaviour and Organisation* 5 (1984): 249-274; and Burton Klein, *Dynamic Economics* (Boston: Harvard University Press, 1977).

⁴³² Carlsson, *supra*, n. 428, at p. 108.

⁴³³ *id.*, at p. 100.

approximately 60 percent of SMEs are innovative according to a recent paper.⁴³⁴ As larger firms downsize and outsource more innovation, the weight of SMEs particularly in the record industry is increasing. On the whole, the music industry (all branches of it, including the live and record industries) generates over 130,000 jobs, contributes £3.2 billion to the value of the UK economy, and makes around £1.3 billion through exports.⁴³⁵ These impressive figures should be contrasted with the fact that over 90 percent of music businesses are SMEs.⁴³⁶ Since digital technology and globalisation reduce the importance of economies of scale, in the record industry in particular, the potential contribution of smaller firms is enhanced.

The importance of SMEs in the record industry has been re-emphasised by the European Parliament (hereinafter, EP) in 2007 after the second approval of the Sony/BMG merger by the Commission⁴³⁷ (this is discussed below in Chapter 5 and in the Conclusion). The EP expressed its concerns about the European Competition Commission's tactics going against the European policy of supporting SMEs in the music sector. The concerns were voiced precisely because independent labels create more jobs than the majors and represent 99 percent of the players in the market as well as 80 percent of the innovation in the sector.⁴³⁸ The EP once again re-emphasised the importance of SMEs in the cultural sector:

“Like many cultural sectors, music suffers from chronic concentration. Artists and cultural SMEs need to be supported as they play a key role in fostering creativity and innovation as well as growth and employment in Europe. We must put cultural diversity at the heart of the EU policy”.⁴³⁹

One of the biggest hurdles in arguing that record industry SMEs should be afforded particular protection by competition law is that small independent labels oppose majors merging because they themselves wish to grow in size.⁴⁴⁰ That being said, as both the meaning and significance of ‘independence’ vary drastically amongst independent

⁴³⁴ See *Organisation for Economic Co-operation and Development*, *supra*, n. 423.

⁴³⁵ Wilson *et al.*, *supra*, n. 410, at p. 2.

⁴³⁶ *id.*

⁴³⁷ *Impala*, “European Parliament Interrogates Commission on the Sony/BMG Merger,” October 30, 2007.

⁴³⁸ *id.* See also *Impala*, “European Parliament Challenges Commissioner Kroes again on SonyBMG,” December 20, 2007.

⁴³⁹ Quoting Guy Bono, member of the European Parliament's Culture Committee. *id.*

⁴⁴⁰ Waterman, *supra*, n. 415.

music labels, not all small companies are growth-oriented.⁴⁴¹ The fact is supported by the reluctance of small firms to adopt the setting of business or growth targets. Several studies confirmed⁴⁴² that a desire for independence, rather than economic incentives, were the prime motivator of small firms. Some independent labels are set up to make a profit; others are more preoccupied with supporting their ideology and music preferences, which obviously throws doubt on their economic efficiency. Moreover, as numerous researches demonstrated, small, growing companies make a huge contribution to employment figures even if they are only a small proportion of the overall small firm population.⁴⁴³

The emphasis here should be in underlining the fact that the majority of small enterprises do not survive and can never compete with large firms. Since the independent sector of the record industry *mainly* consists of small companies with less than 10 employees, the prime task for such small firms is survival, *not* growth.⁴⁴⁴ Even in ‘ideal’ macroeconomic circumstances, the larger majority of small companies do not have an increase in size as their main aim.⁴⁴⁵ Some of the interviewees also confirmed that they would not like to grow at all:

“The last thing I want to do is to become the next major because I have an advantage of being an independent. We have one artist (Katie Melua) on Dramatico. If we had 4 artists, it would be a huge expansion. I do not want to do that.”⁴⁴⁶

In the record industry, there is a multitude of independent labels but the majority of them will never achieve strong economic results and in this sense are inefficient. As noted in Chapter 1, the reality of the situation is that even the smallest major is still

⁴⁴¹ Colin Gray, “Managing Entrepreneurial Growth: A Question of Control?” in *Small Firms: Entrepreneurship in the Nineties*, ed. by David Deakins *et al.* (London: Paul Chapman, 1997), 20.

⁴⁴² See Kevin Caley *et al.*, *Small Enterprise Development: Policy and Practice in Action* (London: Paul Chapman, 1992); Francis Chittenden *et al.*, *Small Firms: Recession and Recovery* (London: Paul Chapman, 1993).

⁴⁴³ David Storey and Steven Johnson, *Job Generation and Labour Market Change* (Basingstoke: Macmillan, 1987) and David Storey, *supra*, n. 425, at pp. 112 – 158.

⁴⁴⁴ Additionally, only a tiny proportion of micro-businesses grow to become significant employers. On the average, about 60 percent of the firms, do not wish to grow. James Curran, “*Bolton 15 Years on: A Review and Analysis of Small Business Research in Britain, 1971 – 1986*” (London: Small Business Research Trust, 1986), at pp. 1- 72. According to a research into 2,517 SMEs, almost two-thirds of them intended to grow, but by growth they meant the increase in their sales rather than taking on more staff. See Gray, *supra*, n. 441, at p. 20.

⁴⁴⁵ Storey, *supra*, n. 425, at pp. 112 – 158.

⁴⁴⁶ Interview with Mike Batt, *supra*, n. 343.

much bigger in terms of size and power than the largest independent.⁴⁴⁷ The above is backed up by the fact that large companies primarily populate the record industry, with only a very small number of medium-sized independents in existence.

Having demonstrated the importance of small firms (independent labels) from both a cultural and an economic point of view, the next step is to investigate the reasons for mergers and acquisitions, the resulting market power of majors, and its abuse by majors.

⁴⁴⁷ Mills, *supra*, n. 201, at p. 8.

Chapter 4: The Rationale behind Mergers and Acquisitions and Resultant Anti-competitive Behaviour

“Come Together, Right Now, Over Me”.

The Beatles⁴⁴⁸

“Big 5, big 4, big 3, big 2, I don’t care. They are digging their own graves”.

Robert Horsfall⁴⁴⁹

“Everybody says that it is going to be the great future for independents, but I am yet to see it”.

Marc Marot⁴⁵⁰

Before undertaking a critical analysis of the EU merger regulation and case law in Chapter 5, this chapter explores the reasons why majors merge and acquire smaller labels as well as their patterns of anti-competitive behavior.

As demonstrated in the previous chapter, majors have long utilised the policy of vertical and horizontal integration. Since vertical integration in today’s digital turmoil becomes less important to majors because they cannot acquire every single digital platform that is springing into existence, this chapter focuses on horizontal integration, i.e. when majors merge with each other or acquire independents; this trend has been particularly noticeable over the last decade. By 1992 the European Competition Commission had recognised that it was already then too late to prevent an oligopolistic record industry concentration but it nevertheless approved the EMI/Virgin merger.⁴⁵¹ Moreover, it is worth mentioning that further down the line in 1995 the Italian competition authority found that the market structure of the record industry was indeed oligopolistic.⁴⁵² In spite of that finding, the Commission authorised the acquisition of PolyGram by Seagram in 1998,⁴⁵³ thus creating Universal, the largest record company in the world. The Commission reasoned in favour of the acquisition because Seagram was not a

⁴⁴⁸ Blue Album 1970 – 1973.

⁴⁴⁹ MusicTank seminar, *supra*, n. 323.

⁴⁵⁰ *id.*

⁴⁵¹ Case No IV/M.202 – *Thorn EMI / Virgin Music*, April 27, 1992, para 22.

⁴⁵² *Associazione Vendomusica / Case Discografiche Multinazionali* by the Autorita Garante della Concorrenza e del Mercato, October 10, 1997, <http://www.ahcm.it>.

⁴⁵³ Case No IV/M.1219 – *Seagram / PolyGram*, September 21, 1998.

major record company in Europe and therefore the acquisition was not deemed to affect the level of concentration in the European music industry.⁴⁵⁴ However, during the Seagram/PolyGram acquisition, the Commission noted: “the oligopolistic structure of the music industry might point to a situation of collective dominance”.⁴⁵⁵ The Seagram acquisition reduced the number of major record companies from six to five. In 2000, EMI and Time Warner notified the Commission of their agreement to merge their respective music businesses. The proposal was withdrawn in the face of a prohibition decision (explained in Chapter 5). However, in 2002 Bertelsmann was given the green light to go ahead in its acquisition of the then largest independent company, Zomba Records,⁴⁵⁶ which does exemplify that the *modus operandi* of majors absorbing independents was intrinsically ‘institutionalised’.⁴⁵⁷ The highly criticised merger between Sony and BMG,⁴⁵⁸ which will be analysed in fine detail in Chapter 5, followed various other mergers and acquisitions. Sony and BMG merged their music entities but not without a regulatory hurdle; the independent labels’ trade body, Impala,⁴⁵⁹ successfully opposed the merger in the Court of First Instance in 2006, resulting in the merger being sent back to the Commission for another investigation. In October 2007, the Commission *unconditionally* approved the merger for the second time.⁴⁶⁰ Following that, in 2008 the European Court of Justice threw out the CFI’s annulment and ordered the CFI to re-investigate the merger.⁴⁶¹ This back and forth fiasco demonstrates how difficult it is for competition law (in this case merger regulation) to deal with cultural industries. Despite Impala’s victory at the CFI in 2006 the wave of acquisitions did not stop. 2007 saw three big acquisitions by Universal, firstly that of the largest independent company in the world, Sanctuary Records,⁴⁶² secondly the acquisition of another renowned label, V2⁴⁶³ and thirdly one of the biggest music publishing catalogues, BMG Publishing.⁴⁶⁴

⁴⁵⁴ *id.*, paras 25-26.

⁴⁵⁵ *id.*, para 29.

⁴⁵⁶ Case No COMP/M. 2883 – *Bertelsmann / Zomba*, September 02, 2002.

⁴⁵⁷ Negus, *supra*, n. 55, at p. 35.

⁴⁵⁸ Case No COMP/M.3333 – *Sony/BMG*, *supra*, n. 315.

⁴⁵⁹ Case T464/04 – *Independent Music Publishers & Labels Association (Impala) v. Commission of the European Communities*, July 13, 2006.

⁴⁶⁰ Case No COMP/M.3333 – *Sony/BMG*, October 03, 2007.

⁴⁶¹ *The Billboard*, “EU High Court Throws Out SonyBMG Annulment,” July 10, 2008.

⁴⁶² Nic Fildes, “Universal Buys Struggling Music Group Sanctuary,” *The Independent*, June 16, 2007.

⁴⁶³ Dominic White and Josephine Moulds, “Universal Agrees to Buy V2 Music for £7m,” *The Telegraph*, 11, 2007.

⁴⁶⁴ Case No COMP/M. 4404 – *Universal/BMG Music Publishing*, May 22, 2007.

This chapter is organised as follows. The first part investigates the conditions that drive forward mergers in the record industry and what effect, if any, such mergers have on small, medium, and large-sized independent labels, artists, consumers, and culture. Following that, a number of examples of anti-competitive practices exercised by the majors are illustrated.

4.1. Reasons for Mergers and Acquisitions in the Record Industry

Before discussing the two crucial mergers of Time Warner with EMI and Sony with BMG, it is firstly necessary to analyse why record companies merge or acquire smaller labels, and what drives this growth ambition. Secondly, what effect these mergers have on small business and music diversity must be discussed. The arguments in this section demonstrate numerous reasons for merging, the prevalent one being the acquisition of copyrights. Greater focus on copyright is also necessary because it is the ‘backbone’ of the record industry; the impact of copyright ownership and protection upon cultural diversity should not be under-estimated.

4.1.1. Copyright’s Role in Creating the Record Industry Oligopoly

The following part starts with the historical development of copyright and explores its role in the commodification of cultural products and creativity. It seeks to argue that copyright law is not designed to stimulate creativity but is there to encourage commercial exploitation and protect investor interests, particularly so those of the majors. Also analysed is how copyright informs cultural diversity, for example how copyright ownership impacts on new forms of creation such as digital sampling.⁴⁶⁵ Moving on, the relationship between copyright and competition law is investigated, in particular the ‘vicious circle’ illustrates that it is copyright that gives majors the market power to consolidate, which in turn gives them more power to acquire more copyrights and stifle cultural diversity. Finally, the last section examines the effect copyright law has on cultural diversity and independent labels, and whether independent labels can provide any answers in terms of how they use copyright and other tools to protect creativity.

⁴⁶⁵ See the glossary for the definition.

4.1.1.A. Historical Development and Justification of Copyright

An understanding of the function of copyright law in the record industry in the twenty-first century would not be complete without a brief discourse into the legal history of copyright law. Copyright - like entitlements, are rooted in Greek and Roman history.⁴⁶⁶ However, it is the development of copyright since the late seventeenth and early eighteenth centuries that is of greater interest and relevance to this thesis. Two of the most important developments occurred in England in the seventeenth and the eighteenth centuries. The first one was the publication of *Two Treatises of Civil Government* by John Locke⁴⁶⁷ who articulated his labour and property doctrines and the justification of the appropriation of property:

“Whatsoever he (person) removes out of the state that nature hath provided, and left it in, he hath mixed his labour with, and joined to it something that is his own, and thereby makes it his property... that excludes the common right of other men: for this labour being the unquestionable property of the labourer, no man but he can have a right to what that is once joined to, at least where there is enough, and as good, *left in common for others*” (emphasis added).⁴⁶⁸

It is not clear whether Locke had intellectual rights in mind when writing the Treatise. Nonetheless, in his other capacities, he was enthusiastic that authors were only allowed copyright protection for a defined period fearing that much work could be lost due to a monopolistic book industry holding on to licenses indefinitely.⁴⁶⁹

The second crucial development was the statutory enactment of copyright law for the first time in England in 1710. The law was titled the Statute of Anne and was designed to be a trade regulation device for book publishers⁴⁷⁰ and *not* so much intended to protect the author's interests. The Statute led to stronger bargaining positions in favour of publishers, consequently weakening the writer's position. America, taking English law as the prototype, similarly introduced laws safeguarding copyright owners rather

⁴⁶⁶ For a detailed history of copyright, see for example, Paul Geller, “Copyright History and the Future: What's Culture Got to Do with It?” *Journal of Copyright Society of the USA* 47 (2000): 209 – 263 and Ronald V. Bettig, *Copyrighting Culture: The Political Economy of Intellectual Property* (Colorado: Westview Press, 1996).

⁴⁶⁷ John Locke, *The Second Treatise of Government* (New York: Barnes and Noble Publishing, 2004), 16 – 30.

⁴⁶⁸ *id.*, Chapter V, Section 27.

⁴⁶⁹ See Peter King, *The Life and Letters of John Locke* (London: Bell and Daldy, 1864), 205. Also cited in Bettig, *supra*, n. 466, at p. 21.

⁴⁷⁰ At the time, the book trade was far from prospering because of the failure to renew the seventeenth century printing licensing laws. See Lionel Bently, “Copyright & the Death of the Author in Literature and Law.” *Modern Law Review* 57, no.6 (1994): 974.

than creators, consequently concerning itself more with book publishers than authors; the situation pretty much exists today.⁴⁷¹ As the discussion below will outline, a similar situation is observed in today's record industry.

4.1.1.B. Function of Copyright and Its Clash with Cultural Diversity

Copyright is the monopoly right, which gives its owners the right to exclude others from copying the work without permission.⁴⁷² Throughout copyright law history there were heated academic debates about the need or otherwise of such a law.⁴⁷³ Some scholars question the case for having copyright at all,⁴⁷⁴ whilst others say it is the only way forward.⁴⁷⁵ That particular debate is predominantly outside the scope of this thesis, instead this part focuses on what copyright protection means for the record industry; whose interests it protects and its relationship with competition law.

Copyright plays a crucial role in certain cultural industries.⁴⁷⁶ Lawmakers emphasise that:

“Copyright...constitutes an essential element in the development process. Experience has shown that *the enrichment of the national cultural heritage depends directly on the level of protection* afforded to literary and artistic works. The higher the level, the greater the encouragement for authors to create, the greater the number of a country's intellectual creations, the higher its renown; the greater the number of productions in literature and the arts, the more numerous their auxiliaries in the book, record and entertainment industries....” (emphasis added)⁴⁷⁷

Some however argue that copyright law works in an opposite way, stultifying creative endeavours.⁴⁷⁸ The crucial limitation of copyright law is that it may, and often does, impair creativity and consequently diversity, particularly exemplified in the light of the

⁴⁷¹ Peter Drahos, “The Visual Artist in the Global Information Economy.” *Communications Bulletin* 14, no. 3 (1995): 1.

⁴⁷² Robert M. Hurt and Robert M. Schuchman, “The Economic Rationale for Copyright.” *The American Economic Review* 56, no. 1/2 (1966): 421.

⁴⁷³ See Edwin Hettinger, “Justifying Intellectual Property.” *Philosophy and Public Affairs* 18, no.1 (1989): 31 – 52.

⁴⁷⁴ Stephen Breyer, “The Uneasy Case for Copyright: A Study of Copyright in Books, Photocopies and Computer Programmes.” *Harvard Law Review* 84 (1970): 281 – 351; Hurt and Schuchman, *supra*, n. 472, at pp. 421 – 432.

⁴⁷⁵ Hettinger, *supra*, n. 473.

⁴⁷⁶ Not all cultural industries are dependent on copyright, for example media industry (newspapers, magazines).

⁴⁷⁷ The preface to the World Intellectual Property Organisation's Guide to the Berne Convention for the Protection of Literary and Artistic Works, WIPO 1978.

⁴⁷⁸ See for example, Fiona Macmillan, “*Copyright's Commodification of Creativity*,” 17.

numerous and successful attempts to increase the duration of copyright (discussed below). The relationship between copyright and creativity is not an easy one, but as was stated in *Atari v. Nintendo*:

“the copyright holder has a property interest in preventing others from reaping the fruits of his labour, not in preventing the authors and thinkers of the future from making use of, or building upon, his advances. The process of creation is often an incremental one, and advances building on past developments are far more common than radical new concepts”.⁴⁷⁹

The next step therefore is to investigate the relationship between copyright law and cultural diversity.

Since copyright is a monopoly right, an important feature is to protect the property interests of its creators and holders. However, copyright law should not just be about preventing illegal users from copying original works. It should address the promotion of innovation and cultural diversity (even though, as pointed out in Chapter 1, cultural diversity is not a stated aim of copyright law). This position is further supported by the US Copyright Act which sets forth the purpose of copyright protection as the promotion of ‘progress of science’,⁴⁸⁰ not the rewarding of authors.

Copyright protection should not necessarily clash with the fostering of creativity and innovation, but unfortunately that is not always the case. Copyright law grants protection to the expressions of ideas, not ideas as such. The threshold of the originality requirement is low, which is of great concern in terms of increasing diversity levels. Protection, through copyright law is not dependent on originality or creativity; in fact the work itself need not be of any artistic merit. This relatively low threshold for originality is one reason to argue that copyright is not supporting creativity and culture.⁴⁸¹ For example, compilation albums are protected by separate copyright arrangements from the original material embodied in them. Moreover, it has long been argued that the concentration of copyright in the hands of a small number of corporations does not facilitate cultural diversity, but does increase profits.⁴⁸²

⁴⁷⁹ *Atari Games Corp. v. Nintendo of America Inc.* 975 F.2d [1992] 832, 839.

⁴⁸⁰ *Sony Corp. v. Universal City Studios*, 464 U. S. 417 [1984], 429-30; *Twentieth Century Music v. Aiken*, 422 U.S. 151 (186 USPQ 65) [1975], 156.

⁴⁸¹ Macmillan, *supra*, n. 478, at p. 2.

⁴⁸² Laurence Lessig, *Free Culture: How Big Media Uses Technology and the Law to Lock Down Culture and Control Creativity* (New York: Penguin Press, 2004); and Fiona Macmillan, “Copyright and

Copyrights can be traded and are not inalienable in themselves but at the same time grant exclusive rights to the holder.⁴⁸³ The copyright is alienable as an author can assign (and often does) his copyright interest; with respect to the record industry, quite often the copyright (in a sound recording) belongs to a record company outright for 50 years. The main reason for copyright transfers to take place is the need for music to be exposed to more consumers.⁴⁸⁴ If a recording artist is contracted to a record company, the recording of the artist's performance becomes the company's property and can be sold or traded without any need for the artist's consent or sometimes knowledge.⁴⁸⁵ Hence, it is argued that in copyright law the concept of authorship leads to commodification.⁴⁸⁶ An evident example of this is the fact that previously copyright on recordings did not vest in artists but in producers, i.e. the latter (a record company in most cases) was recognised as the author of a sound recording⁴⁸⁷ (see the discussion below). The above demonstrates how financial investment outweighs authorship, thus defining a sound recording as a commodity right from the outset. Another couple of reasons that add to copyright commodification are one, copyright protection's increased duration and two, restrictions of fair dealing and fair use defence (the latter being outside the scope of this thesis).⁴⁸⁸

This commodity has become a crucial area of trade; as a consequence, there are robust forms of rights commodification.⁴⁸⁹ However, there exists a point of view that argues that without such commodification copyright law would have greater integrity.⁴⁹⁰ The argument may also be made that some degree of commodification is necessary to provide financial reward for artists. However as shown later, at the present time copyrights are used more to protect the interests of record companies (commodifiers) rather than the artists.

Corporate Power," in *Copyright in the Cultural Industries*, ed. Ruth Towse (Cheltenham: Edward Elgar, 2002), 99.

⁴⁸³ Macmillan, *supra*, n. 478, at p. 3. The term 'alienation' originally signified 'to sale'. See Bently, *supra*, n. 470, at p. 979.

⁴⁸⁴ Birgitte Andersen *et al.*, "*Rents, Rights 'N' Rhythm: Conflict and Cooperation in the Music Industry*," 9, <http://www.copyright.bbk.ac.uk/contents/publications/workshops/theme2/banderson.pdf>.

⁴⁸⁵ Ruth Towse, "Copyright, Risk and the Artist," *International Journal of Cultural Policy* 6, no. 1 (2000): 98.

⁴⁸⁶ Macmillan, *supra*, n. 478, at p. 5 and Garnham, *supra*, n. 19, at p. 141.

⁴⁸⁷ Copyright, Designs and Patents Act (hereinafter, CDPA) 1988 (UK), s. 9 (1) & (2) (aa). This provision has been changed to 'the person who makes the necessary arrangements', which in most cases means a record company. See also John Kay, "Lennon was Right about Music and the Man," *The Financial Times*, 16 April 2008.

⁴⁸⁸ Bently, *supra*, n. 470, at p. 979.

⁴⁸⁹ Macmillan, *supra*, n. 482, at p. 106.

⁴⁹⁰ *id.*

4.1.1.C. Copyright and Globalisation

The importance of copyright to its holders becomes even more evident in this digital age with the globalisation of cultural industries (see the discussion in Chapter 1). Moreover, there are certain trends that point to the globalisation of copyright itself. The exploitation of a small number of copyrights in the record industry is certainly one factor; the increasing legal regulation of copyright on a global scale is another. In the last sixty years copyright has been successfully used as a trade instrument. Good examples of this on a law-making level is the inclusion of copyrights, as well as other intellectual property rights, in the 1947 GATT⁴⁹¹ and the 1994 agreement, TRIPS.⁴⁹² Some see a particular irony in the title TRIPS, as it appears to suggest that the trade related aspect of intellectual property is the only one.⁴⁹³ TRIPS brought the trade aspects of intellectual property into the open, but these tendencies seem to have existed right from copyright's moment of creation. As the TRIPS agreement is arguably one of the most important developments in international intellectual property law since the adoption of the Berne Convention for the Protection of Literary and Artistic Works,⁴⁹⁴ it is unfortunate that its standards for the protection of intellectual property rights set the general trend to strengthen IP protection, with the resulting enhancement of intellectual property's value. It is interesting to note that the US government and private corporations heavily influenced the drafting of the TRIPS agreement.

4.1.1.D. Copyright and Market Power: A Vicious Circle

Copyright law as such does not seem to have raised many issues with competition law in the past but it nevertheless has impacted upon competition within the record industry. The record industry considers copyright as an investment tool and the longer its term, the bigger the return on investment,⁴⁹⁵ which in turn leads to music commodification. The way record companies operate demonstrate that by alienating the artist from their work, (by owning the copyright in their sound recordings) music becomes

⁴⁹¹ General Agreement on Tariffs and Trade, 1947.

⁴⁹² Trade-Related Aspects of Intellectual Property Rights, 1994.

⁴⁹³ Macmillan, *supra*, n. 478, at p. 3.

⁴⁹⁴ Berne Convention for the Protection of Literary and Artistic Works 1886.

⁴⁹⁵ The BPI Report "*Five Reasons to Support British Music: One of the UK's Most Valuable Industries*," May 16, 2007.

commodified⁴⁹⁶ and music moves from the private domain of the author to the domain of the record company. Secondly, it seems that the other root of commodification lies in the numerous mergers and acquisitions in the record industry. This is an inter-dependent process, which in this work is defined as '*the vicious circle*'. Higher consolidation and the resulting market clout affords major record companies acquiring more copyrights, which in turn gives them more market power to buy even more copyrights, and the circle continues. Following on, it is possible to conclude that it is mainly the ownership of copyrights that led to the creation of the oligopolistic power of major record companies.⁴⁹⁷ On the one hand, such a vast concentration of power in four record companies should be of great concern to the competition authorities. On the other hand, it is the competition authorities that have allowed such a vast concentration of copyrights to reside in a handful of record companies. The power of the corporations is self-reinforcing because they can afford to acquire the copyrights or simply put the provisions in their record contracts that demand the assignment of the copyrights to themselves.⁴⁹⁸ This power is expressed by the fact that four record companies have about 75 percent of the market share. At this stage it would be fair to note that market share in itself is not a problem. The problem arises when majors use their power in anti-competitive practices (see the discussion below).

The vicious circle's existence is supported by a thorough analysis of intellectual property's political economy, which in turn provides data on how much intellectual property is concentrated in the hands of a tiny number of corporations.⁴⁹⁹ As shown in Chapter 3, in discussing the growth of the record industry, power, which was gradually built by vertical and horizontal integration,⁵⁰⁰ led to a vast number of copyrights being controlled by four record companies. In this case, there is a direct link between the process of music commodification, copyright and the global domination of four record companies in the recorded music market, resulting in lower music diversity.

⁴⁹⁶ Stratton, *supra*, n. 9, at p. 148.

⁴⁹⁷ Bettig, *supra*, n. 466, at pp. 37-8. For other outcomes of copyright ownership see Richard Epstein, *Intellectual Property for the Technological Age* (University of Chicago: Chicago, 2006).

⁴⁹⁸ This is a standard clause in almost every record contract.

⁴⁹⁹ Bettig, *supra*, n. 466.

⁵⁰⁰ Alexander, *supra*, n. 243 at pp. 113 – 123 and *supra*, n. 172, at pp. 85 – 98.

Independents can play their important role in the de-commodification of music here. According to the latest data,⁵⁰¹ even though the majors' global market share is about 75 percent, they are only responsible for 20 percent of new recordings released. Most of this 20 percent is the same music that is heard all over the world; a result of the globalisation of cultural industries. Arguably, the majors force-feed consumers with Top 40 hits. The independent companies cover the remaining 80 percent of music released. Having 75 percent of the market share allows majors not only to control the music market, but "also control the flow of human ideas, language or speech, emotion and expression"⁵⁰² (as was argued in Chapter 1). Majors act as gatekeepers or filters for people's tastes, which allows "as much cultural diversity as a Macdonald's menu".⁵⁰³ The figures quoted above additionally point to the fact that diversity *is* there, it is just not heard by the audience in its entirety simply because the majority of independents cannot break through the entry barriers for MTV, mainstream television, and radio.

4.1.1.E. Copyright and Competition Law: Finding a Balance

On first inspection, it appears as though the natures of copyright law and competition law are diametrically opposed. Copyright law grants monopoly to authors and copyright holders whereas competition law seeks to control and restrict such monopolies. The conflict may be illustrated by the contradiction between the US Constitution that permits to "promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries"⁵⁰⁴ and the provisions of Section 1 of the Sherman Act (discussed further in Chapter 5) that seek to prevent the formation of monopolies.⁵⁰⁵ One only needs to refer to the current headlines about the numerous attempts to merge the remaining major record companies and publishers to appreciate the scale of the debate. For example, the acquisition of BMG Music Publishing by the Universal Music

⁵⁰¹ Independent sector released 80 percent of new music in 2005. This data is based on the amalgamation of Nielsen Soundscan figures in 2005 (81.65 percent of total US releases were independent), and BPI figures in 2005 (83 percent of total UK releases were independent). See AIM, "Independent Sector Creates World's First Global Licensing Agency," June 6, 2008.

⁵⁰² Andersen *et al.*, *supra*, n. 484, at p. 16.

⁵⁰³ Ann Capling, "Gimme Shelter!" *Arena Magazine* (February / March 1996): 21. Also cited in Macmillan, *supra*, n. 482, at p. 109.

⁵⁰⁴ U.S. Constitution, Article 1, clause 8.

⁵⁰⁵ A good example demonstrating the clash between copyright and competition law in football broadcasting rights is provided in *The Football Association Premier League Ltd v. QC Leisure & ors* [2008] EWHC 44 (Ch), January 18, 2008.

Group⁵⁰⁶ allowing the biggest record company in the world to acquire even more copyrights in music and lyrics, was recently recognised as a possible source of competition law violation and hence had to go through an investigation by the Commission.⁵⁰⁷ Nevertheless, there is almost no academic debate about the interplay between copyrights, mergers, and acquisitions.⁵⁰⁸ The section below will seek to explain such interplay.

There is an obvious inter-connection between the protection of copyrights and the increasing number of mergers, particularly illustrated by the fact that the new wave of record industry mergers has coincided with the end of copyright terms in sound recordings of best selling artists such as Elvis Presley and the Beatles. However, the relationship between copyright and competition law is a multi-faceted one. Both copyright and competition law proclaim championing *innovation* as one of their main goals,⁵⁰⁹ but they do not necessarily manage to achieve this in practice. The resultant increased concentration of copyrights in the hands of the four major players diminishes both cultural diversity and competition in the recorded music market. Thus, a danger of copyright ownership is that it can stifle creativity. An example of this would be for instance, the copyright issues arising when majors use their exclusive rights to either grant or deny licenses for sampling.⁵¹⁰

Just how important the copyright institution is to the record industry is best illustrated by recent calls for the extension of copyrights in sound recordings. The following section will demonstrate that it is predominantly the majors who lobby hard for copyright extension. The section also investigates how the already high concentration of copyrights in the four players affects artists, independent labels and cultural diversity and what independent labels can offer in terms of reducing the power of copyright.

⁵⁰⁶ Louis Hau, "Vivendi Buys BMG Publishing," *Forbes*, May 9, 2006.

⁵⁰⁷ Case No COMP/M. 4404 – *Universal/BMG Music Publishing*, supra, n. 464.

⁵⁰⁸ See Charles McManis, "Intellectual Property and International Mergers and Acquisitions," *University of Cincinnati Law Review* 66 (1998): 1283.

⁵⁰⁹ For more on the copyright's function to foster innovation see Martin Kretschmer, "Creativity Stifled? A Joint Academic Statement on the Proposed Copyright Term Extension for Sound Recordings," *European Intellectual Property Review* 30, no. 9 (2008): 342.

⁵¹⁰ Kembrew McLeod, "How Copyright Law Changed Hip Hop," *Stay Free!* 20 (Fall 2002); Greg Gillis, "Girl Talk: The Art of Sampling," *The Times*, November 23, 2008; *Grand Upright Music, Ltd v. Warner Bros. Records, Inc.* 780 F. Supp. 182 [1991]; *Campbell v. Acuff-Rose Music, Inc.* 510 U.S. 569 [1994]; *Newton v. Diamond and Others* 349 F.3d 591 [2003]; *Positive Black Talk, Inc. v. Cash Money Records, Inc.* 394 F.3d 357, [2004]; *Bridgeport Music, Inc. v. Dimension Films* 410 F.3d 792 [2005].

4.1.1.F. Exploitation of Copyright by Majors and Independents: The Case of Copyrights in Sound Recordings

In this part, the case of copyright in sound recordings is used as a tool to show how both majors and independents exploit copyrights and the resulting effect on cultural diversity.

The life of a piece of music, as a financial asset, is dependent upon the duration of its copyright. Therefore, copyright term's duration has always been of pivotal importance to the record industry. In the UK, copyright in the *composition* (lyrics and music) lasts for 70 years from the end of the calendar year in which the author dies.⁵¹¹ By contrast, the duration of copyright in *sound recordings* (master tapes⁵¹² or files) is 50 years from the end of the year in which the sound recording is made or first released whichever is the later.⁵¹³ By comparison, in the USA post Sonny Bono Act⁵¹⁴ copyright in composition lasts for the life of the author plus 70 years, or 95 years for a work of corporate authorship,⁵¹⁵ and the duration of copyright in sound recordings is 95 years. It is worth noting that initially the duration of copyright protection was 14 years, however thanks to the heavy lobbying of big corporations in the US alone, it was gradually stretched to over 100 years.⁵¹⁶

A new wave of attempts to extend the copyright term began particularly since 2003 when there was a real threat that the songs of such high profit-netting artists like Elvis Presley and the Beatles would come out of copyright term and enter the public domain.⁵¹⁷ Another reason for the attempts to extend the copyright term is the digital revolution with its countless music download websites, some of them legal, but most of

⁵¹¹ Section 12 of the CDPA 1988.

⁵¹² See the glossary for the definition.

⁵¹³ Section 13A (3) of the CDPA provides that a sound recording is 'released' when it is first published, played in public, broadcast, or included in a cable programme service.

⁵¹⁴ Sonny Bono Copyright Term Extension Act, 17 USC, October 27, 1998.

⁵¹⁵ Jack Bishop provided a salient example of how creativity is locked up due to constant copyright term extensions. In a hypothetical scenario, a composer dies at the age of 70 in 2025. At this point the 70 years of protection after his death kick off until 2095. However, as it is the corporation that holds the copyright (in the US), the protection is extended to another 25 years, thus totalling 95 years. Therefore, the corporation controls the copyright and use of the work until 2120. See Bishop, *supra*, n. 236, at p. 454.

⁵¹⁶ Chris Sprigman, "The Mouse that Ate the Public Domain: Disney, the Copyright Term Extension Act, and *Eldred v. Ashcroft*," *Findlaw's Writ*, March 5, 2002.

⁵¹⁷ Nigel Hunter and Emmanuel Legrand, "Clock Ticking on Elvis Hits: Biz Seeks Euro Copyright Extension," *The Billboard*, July 24, 2004.

them illegal. As has been put by a music industry insider, “the digital revolution threw a panzer division into copyright”.⁵¹⁸ Having said that, majors still consider copyright as their biggest asset, hence their huge amount of lobbying for copyright extension in sound recordings.

As noted earlier, a copyright confers a monopoly right to the author and copyright-holder. From copyright’s moment of creation it was important that such a monopoly would be limited in time so as to protect the public interest in having access to the works. Despite that, there has been a wave of copyright term extensions in both the UK and the USA.⁵¹⁹ Interestingly, it is predominantly record and entertainment companies (not the artists) that have lobbied and still continue to lobby for the extension of copyright protection because it is such a crucial trade instrument for them:⁵²⁰ the longer the duration, the higher the asset value, and the bigger the return on investment. The possible extension of copyrights in sound recordings provides the best illustration of just how important copyright is to the majors and how the longer copyright term impairs cultural diversity.

The Copyright Designs and Patents Act sets out in Section 9 (1) that *author*, in relation to a work, means “the person who *creates* it”. Therefore, a copyright in composition belongs to the lyricist and music composer unless they assign it to a record or publishing company. Section 9 (2) defines the *author* of sound recording, as the person by whom “the arrangements necessary for the making of the recording are undertaken”. The person who makes the “necessary arrangements” for the making of recordings is the first author and owner of the recordings for the duration of copyright. “Necessary arrangements” are generally interpreted as meaning the person who *pays* for the recording costs. This is often a record company⁵²¹ but can be a production company or an artist.

Under a traditional recording contract the record company pays for the recording costs and owns the recordings for the duration of copyright (50 years) and the copyright in the

⁵¹⁸ Quoting Tim Clark at MusicTank seminar, “Cheques, Hugs & Rock ‘n’ Roll: The Changing Face of Artist Management.” 5 December 2007.

⁵¹⁹ In Europe the recent increase in copyright term took place in 1993. Council Directive 93/98/EEC, [1993] OJ L 290/9. In the USA the last attempt to increase the copyright term culminated in the Copyright Term Extension Act (Sonny Bono Act) in 1998.

⁵²⁰ Macmillan, *supra*, n 478, at p. 4.

⁵²¹ Kay, *supra*, n. 487.

recordings is never assigned to the artist. This practice has long been the case. If, after some years, the artist's career goes through a period of low sales the record company will usually delete⁵²² certain albums, as it is not profitable for them to continue to make them available at retail. This is effectively keeping art from the consumers and diminishing the potency of the Long Tail economies.

In cases when a copyright in sound recording belongs to a record company, often the artist will approach the record company to see if it is possible to have the sound recordings back (possibly by paying the record company an override percentage) or if it is possible to license their own recordings back from record company either for their own use or to license on to third parties. This is often denied, despite the fact that the artists might have recouped the costs of the recordings from their royalties. As exemplified by Billy Corgan of Smashing Pumpkins:

“We’ve made offers to buy it (their back catalogue) all. Look, you have no interest. Let us just buy it. But they won’t pull a number on it. They’ve atrophied the catalogue down so low that they probably hope we’ll crawl back and ask for cash”.⁵²³

Major companies will often hold on to copyrights just in case there is suddenly a revival of that particular genre or for example a request for the music to be used in a film, advert, or computer game. There is no obligation or incentive for the record company to actively exploit the recordings. Thus there are often situations existing where artists are denied an income even if their recordings are still protected by copyright law, whilst the consumers are denied access to the artists' recordings. This, in itself, represents a competition law issue. Artists, in their turn, use different tactics to obtain their income from the sound recordings that they had assigned to majors earlier in their careers. Re-recording back-catalogues is a new trend in the record business which allows artists to keep the copyright in sound recordings to themselves.⁵²⁴

Interestingly, a few years ago BMG (before its merger with Sony) substantially revised its long form recording agreement and made it more transparent. The new BMG

⁵²² See the glossary for the definition.

⁵²³ Jonathan Cohen, “Smashing Pumpkins Lawsuit Latest Step in Feud,” *The Reuters*, March 27, 2008.

⁵²⁴ Such tactics have already been employed by artists like Twisted Sister, Pointer Sisters and Simply Red. Jeff Leeds, “Remaking Old Hits to Earn New Money,” *The New York Times*, April 18, 2007.

contract contained⁵²⁵ no royalty deductions, instead monthly accountability clauses were introduced, and video costs were made non-recoupable. In addition, the term of the contract was made shorter with fewer options. One of the most important provisions was that the record company would own the copyright in a sound recording for the term of the contract plus five years after the end of the term. Thereafter, if a record company still wanted to keep the sound recordings, it would have to pay a further advance to the artist (which would have been related to the royalty earnings in relation to those sound recordings). Thus the artist could have received the sound recordings back *if* the record company was not interested in them. The contract also contained a profit share arrangement of 50:50. This was a promising contract, which was much discussed in music circles; however, the merger between Sony and BMG stifled its implementation. Moreover, majors and some independents are introducing ‘360-degree’ deals pursuant to which record companies have a slice of not only copyrights, but touring and merchandising income too.⁵²⁶

The above discussion illustrates that copyright affects the interests of major record companies, independent labels, artists and the public. The discussion below demonstrates how majors, independents, and artists approach copyright and its numerous extensions, i.e. the majors mainly lobbying for copyright term extension in order to preserve their profits; the same trend is observed by the larger independents and a selection of rich artists. However, there is also a movement of independent labels and artists who do not want the copyright term extension in sound recording, mainly because some labels and artists see it as too restrictive, expensive for releasing their art, and impairing cultural diversity as a result.

⁵²⁵ As described by Clive Rich at MusicTank seminar: “Entering the Age of Aquarius? A New Dawn for the Recording Contract.” 21 January 2004.

⁵²⁶ See *The Economist*, “A Change of Tune,” July 5, 2007; Susan Butler, “Music Biz Lawyers Wary of Labels’ New Grab,” *The Billboard*, December 28, 2007; Paul McGuinness, a Keynote Speech at MIDEM, “Online Bonanza: Who Is Making the Money and Why Aren’t They Sharing It?” January 28, 2008; Andrew Edgecliff-Johnson, “Warner Set to Change its Tune on Digital Links,” *The Financial Times*, August 8, 2007; Clare Matheson, “Music Giants Change Their Tune,” *BBC*, September 13, 2007; Samantha Marshall, “Diddy on the Art of 360 Deals,” *Crain’s New York Business*, November 18, 2007; Jeff Leeds, “Korn Sells a Stake in Itself,” *The New York Times*, January 11, 2006; Michael Arrington, “360 Music Deals Become Mandatory as Labels Prepare for Free Music,” *Techcrunch*, November 8, 2008.

4.1.1.F.i. Artists' Response to the Extension of Copyright Term

It must be noted that, the majority of artists do not lobby for copyright extension because they do not benefit from it. The scarce research⁵²⁷ into artists' copyrights shows that a very small proportion of artists are able to make a living from their copyrights. Only a very small number of artists (predominantly the highest selling stars) have high incomes and their copyrights in music these days do not account for the biggest slice of their income.⁵²⁸ By comparison, most artists' incomes are lower than the national average.⁵²⁹ Ironically, the richer the artist, the more lobbying outcries are heard:⁵³⁰ only a tiny number of household names like Mick Hucknall and Cliff Richard gave their support on the extension of the copyright term in sound recordings stating that it was hugely unfair that the artists who recorded the songs would lose the copyright protection in 50 years time. What has not been mentioned is that artists inevitably borrow from different genres and influences, amalgamate ideas, and then create an original work. Therefore, the greater the copyright protection the more difficult it is for artists to create and release their music. The fact that artists are not being allowed to cross-fertilise ideas impacts negatively on musical creativity.

4.1.1.F.ii. Majors' Response to the Extension of Copyright Term

When lobbying for the copyright term extension, both major record companies and trade bodies reason that without it the market would stop functioning,⁵³¹ because the legitimate artist or producer who created and paid for the work would not be able to protect it (and its income) from unauthorised users. Therefore, the argument is that copyright does protect producers and creators by enabling them to control and economically exploit their rights and therefore gain back their production costs.⁵³² It is also claimed that a longer copyright term allows record companies to invest more in

⁵²⁷ Ben Fenton, "CDs Slip Down Songwriters' Revenue Chart," *The Financial Times*, October 22, 2008; Sannosuke Matsumoto, "Performers in the Digital Era: Empirical Evidence from Japan," in *Copyright in the Cultural Industries*, ed. Ruth Towse (Cheltenham: Edward Elgar, 2002), 196; Martin Kretschmer, "Copyright and Contracts: A Brief Introduction," *Review of Economic Research on Copyright Issues* 3, no. 1 (2006), 75; Martin Kretschmer, "Artists Earnings and Copyright: A Review of British and German Music Industry Data in the Context of Digital Technologies", *First Monday* (2005).

⁵²⁸ Kretschmer (2005), id., at p. 7.

⁵²⁹ Towse, *supra*, n. 485, at p. 96.

⁵³⁰ Andrew Orlowski, "Sir Cliff Cost Us Copyright Battle," *The Register*, January 25, 2007.

⁵³¹ Towse, *supra*, n. 485, at p. 95.

⁵³² id., at p. 96.

discovering and releasing new artists. This indeed is not an easy case to answer. It seems that the record industries' interests are disguised (as explained below) by the fact that artists do not receive an appropriate remuneration after the copyright term, in case of sound recordings 50 years, is over.⁵³³ On the other hand, the argument is that Elvis Presley is dead and can no longer benefit from the sales of his recordings, thus the only party that can benefit from a longer copyright term is his record company. As regards the need of copyright to release more artists, the latest figures confirm that all majors have actually decreased their artist rosters in the digital age.⁵³⁴

What is not being mentioned however, is that majors can and do lock down previous recordings in their archives.⁵³⁵ For example, only about one third of classical recordings originally released by EMI are now available.⁵³⁶ EMI would not reissue lesser-known artists like Gracie Fields or Maud Powell because the potential market is too small for their economies of scale. This situation describes why classical independent labels such as Naxos become increasingly important.

4.1.1.F.iii. Independents' Response to the Extension of Copyright Term

In the above respect, it is appropriate to see why the independents' trade bodies (i.e. those who represent dance, hip-hop and jazz labels and many others, who it seems, should be against the longer copyright term) also joined the campaign for the copyright extension and championed how it could benefit small labels. This stance is particularly interesting because such a study has not been carried out before; hence the analysis is based primarily on the data collected from the interviews.

First of all, it is important to state that *not* all independent labels are in favour of copyright term extension. Presently, the license called Creative Commons (hereinafter, CC) is becoming more popular among small labels. CC signifies that the public can

⁵³³ BBC, "Musicians Urge Copyright Change," November 26, 2008.

⁵³⁴ See the analysis of the second approval of SonyBMG below in Chapter 5.

⁵³⁵ On the misuse of the copyrights see Siva Vaidhyanathan, *Copyrights and Copywrongs: The Rise of Intellectual Property and How It Threatens Creativity* (New York: NYU Press, 2001) and David Bollier, *Brand Name Bullies: The Quest to Own and Control* (San Francisco: Wiley & Sons, 2005). For more arguments against copyright extension see Kretschmer, *supra*, n. 509, at pp. 341 – 347.

⁵³⁶ Michael Church, "Sold for a Song; Small Labels Are Cashing in as the Copyright Expires on Recordings Owned by the Majors," *The Independent* (Music supplement), November 30, 2006, at p. 13.

legally share, remix, and reuse the musical works. CC is placed midway between copyright — *all rights reserved* — and public domain — *no rights reserved*.⁵³⁷

CC sets free musical works for non-commercial uses, i.e. music fans can use the music licensed under CC for non-commercial sharing and commercial sampling of the songs, but the use of the material for commercial purposes, e.g. advertising, is restricted. Unfortunately, there is no data with regards to how many independent labels employ the CC concept, but their numbers should not be underestimated. Since 2000 the CC movement turned into a *copyleft* movement and it is becoming increasingly popular amongst the small labels that can not break through the mainstream entry barriers and who have a message (most likely anti-major and ideological) they wish to broadcast, e.g. Skinny Dog Records, Fading Ways Records, Magnatune, Loca Records, Nine Inch Nails and Positron! Records. The supporters of CC are not against the concept of copyright. They are, however, against numerous copyright extensions. Curiously, even independents' trade bodies, such as AIM and Impala, disregard the diversity of labels they represent, with Impala, for example, including *all* its members into the campaign to unite their efforts for copyright enforcement with major record companies. This step infuriated a few labels using the CC concept: "I think it is very dangerous when Impala got us on their members' list; it was a public list printed in the Popkomm⁵³⁸ guide and it was at the time when they were lobbying for the Directive on enforcement of copyright".⁵³⁹

During the interview stage, those labels that *are* in favour of the copyright extension produced some very interesting answers. The first line of responses can be classified as "the whole industry exists because of the artists, and therefore, the latter need to be

⁵³⁷ For more details see the official Creative Commons website, <http://creativecommons.org/about/>; Slater J. Berry, *Underneath the Knowledge Commons* (London: Mute, 2005); Mikko Valimäki, *The Rise of Open Source Licensing: A Challenge to the Use of Intellectual Property in the Software Industry* (Helsinki: Turre Publishing, 2005); Simon Trask, "Creative Commons, Copyright & The Independent Musician." *Sound on Sound* (January 2005); and Mike Sterry, "The Slip," *The New Music Express*, May 15, 2008.

⁵³⁸ This is an annual music industry conference in Germany.

⁵³⁹ This happened when Fading Ways Records joined AIM. The founder of Fading Ways Records, Neil Leyton, specifically inquired whether AIM would be lobbying for the copyright extension, and if the answer would be 'yes', he would have not joined AIM. The President of AIM assured him that no such action would take place via AIM. However, what Neil Leyton did not know was that upon joining AIM, his label would automatically become a member of Impala (European Independent Music Labels Association) and the latter joined the majors in lobbying for the copyright enforcement Directive 2005. Interview with Neil Leyton, *supra*, n. 346.

protected”.⁵⁴⁰ Some emphasised the artificial differences between songwriters and artists, because the songwriters’ copyright term is the life of a composer / lyricist plus 70 years after his / her death, whilst copyright for the artists’ sound recordings is for just 50 years.⁵⁴¹ When these interviewees were confronted with the question that the majority of artists cannot and do not make their living out of the copyrights, there was either consent or disagreement with that fact. Others, however, had a more shrewd approach:

“This is called the hypocrisy of human being. When I was just an artist, I used to rage against the record companies because if an artist recouped his work, then under the copyright law, he should still be the owner of the copyright because he paid for it. Now I am sitting in a position of the owner of the record company and I do not want the artists to own the copyrights because it was me who paid for them”.⁵⁴²

The main advantage of the extension of the copyright for independents is that they can do reversion deals, i.e. a label can license its artist’s recordings for a limited number of years, and then the rights return back to the label or artist.⁵⁴³ However, the above scheme can only benefit medium to large independent labels, and very rarely the small ones, which occupy the largest slice of the independent sector. Some of the interviewees who are pro copyright extension believe that there should be a *maximum* term of copyright in sound recordings for which the copyright can be owned by the labels and then returned to the creators,⁵⁴⁴ i.e. the performers should obtain their copyrights back automatically if the company has not used the song for 20 years. It is in this area that some independents can and do play their role in democratising record industry standards.

Even if some independents can benefit *financially* from the copyright extension, it is less clear whether they will benefit from the *cultural* viewpoint. Something I felt the independents do not realise. Although, as a general rule, any label or artist can record songs that have already been released (for example a label can take a released Kate Bush song to make a new version of it on its artist’s album), there are a few exceptions. As explained by one interviewee, from a label point of view it makes sense to be in favour of the copyright extension. On the other hand, when independents are doing

⁵⁴⁰ Interview with Adjei Amaning, supra, n. 347.

⁵⁴¹ Interview with Keith Harris, supra, n. 370.

⁵⁴² Confidential source.

⁵⁴³ Interviews with Safta Jaffery, supra, n. 391 and Geoff Travis, supra, n. 352.

⁵⁴⁴ Interview with Keith Harris, supra, n. 370.

cover versions or samples, it makes life more difficult for them: “we only have one band that does cover versions but this is our only expensive band,⁵⁴⁵ and if the copyright term is extended, the recording of their albums becomes more expensive”.⁵⁴⁶ Despite that, since 2005 there have been multiple calls from the record industry, including trade bodies for the independent sector, to extend the copyright term in sound recordings.

4.1.1.F.iv. Recent Attempts to Extend the Term of Copyrights in Sound Recordings: Industry Response

The importance of copyrights to majors in the twenty-first century shows no signs of weakening. The latest desire to extend the copyright term for sound recordings in the UK was expressed in the consultations preceding the Gowers Review of Intellectual Property. The major record companies and their trade bodies, the BPI and the IFPI, leapt on to the idea of copyright term extension. However, even despite heavy lobbying, the Gowers Review recommended *not* to extend the copyright term in sound recordings.⁵⁴⁷

Post Gowers Review, the majors and their trade bodies again used all their lobbying powers to extend the copyright in sound recordings from 50 to 95 years.⁵⁴⁸ The lobbying attempts re-appeared with new vigour after the publication of the Culture Select Committee’s Report that recommended a copyright extension on grounds of fairness.⁵⁴⁹ Even David Cameron, the Tory leader, sided with the majors, although in his view, the term extension should be limited to 70 years.⁵⁵⁰ In justifying his desire to extend the copyright term, David Cameron stated that a longer term would be good for the artists and consumers because the majors would have enough incentive to digitise both older and niche repertoire which more people could enjoy at no extra cost.

⁵⁴⁵ This is so because in this case the label has to pay for the copyrights in compositions.

⁵⁴⁶ Interview with Janine Irons, *supra*, n. 342.

⁵⁴⁷ Recommendation 3 in “*Gowers Review of Intellectual Property*” (2006).

⁵⁴⁸ The BPI Report, *supra*, n. 495.

⁵⁴⁹ *Department for Culture, Media and Sport*, “Staying Ahead: the Economic Performance of the UK’s Creative Industries”, 25 June 2007, para 236.

⁵⁵⁰ David Cameron, “*Call for Extension in Copyright Term*,” Keynote Speech at the BPI AGM, 04 July 2007.

On the one hand, lobbyists state that a longer copyright term is necessary to benefit the *artists*. On the other hand, as stipulated in the majority of recording contracts and the law, the copyright in sound recordings belongs predominantly to the *record companies*. This explains why in the lobbying documents the word ‘artist’ is mentioned in very few instances, whereas the interests of ‘investors in sound recordings’ are mentioned in nearly every sentence.⁵⁵¹ As it stands at the moment of writing, the UK Government rejected the proposal of the Culture Select Committee once again on the grounds that by extending the term the majority of artists would not benefit and such an extension would not encourage new musical works.⁵⁵² On the European level, an independent report, launched by the European Commission also considered the copyright extension and reached the same conclusion as the Gowers Review.⁵⁵³ However, the lobbying powers of majors and their trade bodies still seek to extend the copyright term in sound recordings at the European level.⁵⁵⁴ Their attempts have still failed right up to the moment of this research’s submission.⁵⁵⁵

What this section has shown is that copyright has a number of different functions. Whilst initially its philosophy stood for remunerating the author, in reality particularly in terms of competition law, copyright protects and increases the investment of the bigger corporations, whilst at the same time stifling diversity. Thus, as the majors are becoming increasingly vulnerable in this digital age, their main efforts are focused on holding copyrights for as long as possible. Appetite for copyrights was shown to be an important reason for merging, but it is *not* the only reason. Other reasons are explained below.

⁵⁵¹ See for example, the BPI Report, *supra*, n. 495.

⁵⁵² *Department for Culture, Media and Sport*, “Government Response to the Culture, Media and Sport Select Committee Report into New Media and the Creative Industries.” (2006).

⁵⁵³ *Europa*, “The Recasting of Copyright and Related Rights for the Knowledge Economy,” November 2006, Institute for Information Law, University of Amsterdam, 83 – 136.

⁵⁵⁴ *Europa*, “Music Copyright to Be Extended to 95 Years.” January 12, 2009; Patrick Foster, “Musicians Celebrate Victory as Go-ahead Given for Copyright to Be Extended to 95 Years,” *The Times*, February 13, 2009.

⁵⁵⁵ Andre Paine, “U.K. Biz 'Disappointed' at EU Term Extension Rejection,” *The Billboard*, March 27, 2009.

4.1.2. Other Reasons for Mergers and Acquisitions in the Record Industry

Although a substantial amount of research has been carried out investigating why companies prefer to merge,⁵⁵⁶ the record industry needs to be studied differently for a number of reasons. For instance, most companies (outside of the music business) merge and by their increased market power are able to increase prices to their consumers. By contrast, the record industry is unlikely to have price increases on its agenda because their CDs are already overpriced.⁵⁵⁷ Therefore what the record companies aim to achieve by merging, are not price increases but the growth of such *non-price* issues as artist acquisition, marketing and promoting. These points should be borne in mind during the future discussion in this thesis concerning non-price factors. Another specific reason for mergers in the record industry is that it has faced a number of particular problems and concerns. As previously demonstrated and detailed in the historical background, the record industry is, and was, cyclical. It has experienced booms and declines, particularly so when new technology emerged into the marketplace. Thus, in the accelerated innovations of the digital era, merger deals could be validly considered as responses to some of the challenges the industry currently faces (see Section 3.1.9).

One of the reasons that companies within the cultural sector merge is to attract the required high levels of investment. Investment levels have decreased with the onset of the digital era. From the year 2000, the amount of CD and DVD piracy in addition to the general economic downfall⁵⁵⁸ produced a shock reaction amongst the majors. Adding to those problems, illegal file sharing (Peer to Peer or P2P websites) made it even easier for consumers to disregard CDs.⁵⁵⁹ As one of the interviewees put it: “why would anybody be paying for music if people can download this stuff free?”⁵⁶⁰ As

⁵⁵⁶ See for example, Gregor Andrade *et al.*, “New Evidence and Perspectives on Mergers.” *Journal of Economic Perspectives* 15, no. 2 (2001): 103-120; Farok Contractor and Peter Lorange, *Cooperative Strategies in International Business* (Lexington, MA: Lexington, 1988) and Thomas Krattenmaker and Steven Salop, “Competition and Cooperation in the Market for Exclusionary Rights.” *American Economic Review* 76 (1986): 109 – 113.

⁵⁵⁷ Case No COMP/M.3333 – *Sony/BMG*, supra, n. 315, at paras 56 – 9.

⁵⁵⁸ See for example, Katie Allen, “Record Labels’ Woes Deepen Warner Losses,” *The Guardian*, May 9, 2008.

⁵⁵⁹ According to the Recording Industry Association of America, free downloads outnumber legal downloads by 40 to 1. Some industry figures, however, think that this is an underestimate: “If the RIAA says it’s 40 to 1, then it’s probably 100 to 1.” See Andrew Orłowski, “Free Music Has Never Looked so Cheap,” *The Register*, April 3, 2007.

⁵⁶⁰ Interview with Bobby Colomby, supra, n. 297.

discussed in Chapter 3, the majors have opted to fight illegal file-sharing websites⁵⁶¹ and file-sharers⁵⁶² and they have succeeded in some cases. However, they do not have the power to either sue every single file-sharer nor can they shut down every single illegal file-sharing network.⁵⁶³ In addition to that, record companies have compounded their problems by letting companies outside of the music world grab distribution power, e.g. supermarkets and the Apple Corporation.⁵⁶⁴ One of the interviewees too, fully concurred that supermarkets now have more power than record companies.⁵⁶⁵

“One of the mistakes majors made was to hand over the power to the supermarkets that now control and bully the record companies. If there is a big release coming out, sometimes majors do not even have a say in what the artwork might look like. This is ridiculous. When it comes to that, independents are not even in the game. You cannot even get through the door if you are an independent. They will not even pick up the telephone; you will not get a meeting with them.”

Ironically due to their size, majors in many respects are archaic, particularly so when there are technological advances available to the consumer. These large companies do not seem to be able to embrace new opportunities that come along with new technologies that are not under their immediate control.⁵⁶⁶ Perversely, the policy is to fight these innovations vehemently as was the case with the arrival of radio, TV, and video. A similar reticence is now being witnessed with the arrival of, and ever increasing rate of innovation within digital technology (for more details see Chapter 3).

Mergers and acquisitions also allow the newly formed entity to carry out extensive cost saving programmes,⁵⁶⁷ most often by laying off hundreds of employees,⁵⁶⁸ and artists.⁵⁶⁹

⁵⁶¹ The majors have won the lawsuit against software manufacturers in 2005. See *MGM Studios, Inc. v. Grokster, Ltd.*, supra, n. 315.

⁵⁶² John Lettice, “Much More to BPI’s Fileshare Suits, but Where’s the Fire?”, *The Register*, October 18, 2004.

⁵⁶³ In this case, the Government could undertake some actions to prohibit illegal file-sharing like it does in case of child pornography, for example. See Ben Hall, “France Plans to Cut Off Internet Pirates”, *The Financial Times*, November 22, 2007.

⁵⁶⁴ Andrew Orlowski, “Apple, Tesco ‘Most to Blame’ for Music Biz Crisis,” *The Register*, October 19, 2007; Tim Arango, “Despite iTunes Accord, Music Labels Still Fret,” *The New York Times*, February 2, 2009; *The Los Angeles Times*, “Rage Against the iMachine,” September 6, 2008.

⁵⁶⁵ Interview with Safta Jaffery, supra, n. 391. See also David Sinclair, “Store Wars,” *Independent Music*, November 30, 2006, 14; *Music Week*, “Independent Retailer Round Table,” October 2, 2005; and Jon Rees, “Tesco Puts Squeeze on Music Industry,” *Mail on Sunday*, March 30, 2008.

⁵⁶⁶ For example, one of the main reasons why the CD was embraced by majors is because the technology was invented and controlled by Philips and Sony.

⁵⁶⁷ Dominic White, “EMI Executives Face Losing Bonuses,” *The Telegraph*, December 07, 2007; Sabbagh, supra, n. 317.

⁵⁶⁸ Christopher Walsh, “BMG, Sony, Zomba Announce Studio Closings, Staff Cuts,” *The Billboard*, December 15, 2001; Dominic Rushe and James Ashton, “2,000 Jobs on the Line at EMI,” *The Sunday*

As an example of further economies, a merged entity saves many millions in membership fees for record industry trade bodies such as the IFPI, the BPI and the RIAA.⁵⁷⁰ Hence, if mergers in the twentieth century could be considered as mainly the intention to grow, the desire to merge in the twenty-first century can be seen much more as a *defensive* move. Alongside that however, there is an *aggressive* element to mergers too.

As exemplified in the preceding section, one of the crucial reasons for merging is to facilitate the major record companies' pursuit of consolidating a vast number of copyrights. The consolidation of such rights does afford them the power to extend the private ownership of musical recordings with the subsequent consolidation of the required market *power* (and the market *share*) for promoting their products (see the discussion below on anti-competitive practices). As Keith Harris explained: "Partly, it is the economies of scale and partly it is the market clout; the bigger the company, the more things you can do".⁵⁷¹ The rationale driving the desire to extend the majors' market power is that in so doing new companies are excluded from the market; therefore the existing oligopolistic advantages are secured for a longer period.⁵⁷² Of course, there are thousands of independent labels and it can be argued that the entry barrier into the record industry is now very low indeed, principally because the costs of recording a *cheap* album in the digital age have fallen. Free entry is an important factor in competition but it does not mean that a new company can enter and immediately be as profitable as an established company,⁵⁷³ because the record industry is a sunk cost⁵⁷⁴ industry. It is indeed comparatively simple to set up business as a record company as long as the company has a repertoire source, whether it is in the form of a recording contract with an artist or has acquired some copyrights in recordings that have already been produced. It is not necessary to own a recording studio, manufacturing facilities or a distribution network since all of these can be hired on the open market when required. Thus, the barriers to entry are low. However, for the purposes of the future discussion

Times, January 13, 2008; Richard Wachman, "EMI Cuts Threaten 2,000 Staff," *The Observer*, January 13, 2008; Courtney Harding, "Layoffs Continue at Island Def Jam," *The Billboard*, December 03, 2007.

⁵⁶⁹ Adam Sweeting and Juliette Garside, "Guy Hands: EMI Must Dump Artists to Survive," *The Telegraph*, January 19, 2008.

⁵⁷⁰ Sabbagh, *supra*, n. 317 and Joshua Chaffin, "EMI Threat to Music Trade Bodies," *The Financial Times*, November 28, 2007.

⁵⁷¹ Interview with Keith Harris, *supra*, n. 370.

⁵⁷² George J. Stigler, "Monopoly and Oligopoly by Merger," *American Economic Review* 40 (1950): 25.

⁵⁷³ *id.*, at p. 27, and specifically about the record industry, see Miranda Sawyer "It's No Way to Make a Living These Days," *The Observer*, February 17, 2008.

⁵⁷⁴ As explained in Section 3.3.

of consolidation, differences should be drawn between the low cost threshold of setting up and running a label against the running of a label and making it *competitive* in the market. In fact, some small label owners made it clear that in terms of distribution and marketing, there is *no* difference between the digital and physical ages. In the words of Janine Irons,⁵⁷⁵ the CEO of an independent jazz label:

“The digital thing does not really improve anything...when you go on iTunes, it is all Universal and Sony. How do we get past all that? We are on iTunes and we are also in the shops, but with jazz it is always in the basement or on the top floor and it is the same thing in the digital area - the front page is Universal and Sony.”

Therefore, even in the digital age, majors seek to dominate distribution channels and becoming fewer in number can certainly facilitate achieving this goal. Although it seems that vertical integration is not that important to majors now and their sales power has slipped into the hands of other companies, for example Apple, majors may still produce anti-competitive effects, such as foreclosure⁵⁷⁶ and others (see the discussion below).

In addition to the increased market clout merged companies can command, mergers allow the companies involved to obtain overseas experience, e.g. knowledge of consumers' preferences and cultural specificity.⁵⁷⁷ For example, PolyGram was a very successful record company in Europe but it did not share the same level of success in the USA. Likewise, EMI has been a European leader for years but not so successful in the USA. Similar circumstances may be noted regarding the Sony and BMG merger.

However, not all mergers lead to a success story. Often, the frenzy to increase market share does produce negative side effects on the merged companies, as well as on the smaller businesses and consumers.⁵⁷⁸ For example, the 1989 merger between Warner Communications and Time Inc. made Time/Warner the largest media conglomerate in

⁵⁷⁵ Interview with Janine Irons, *supra*, n 342.

⁵⁷⁶ See the glossary for the definition.

⁵⁷⁷ Stephanie Peltier, “Mergers and Acquisitions in the Media Industries: Were Failures Really Unforeseeable?” *Journal of Media Economics* 17, no. 4 (2004): 264-5.

⁵⁷⁸ *id.*, at pp. 261 – 278 and William Fruhan, “Pyrrhic Victories in Fights for Market Share.” *Harvard Business Review* 50, no. 5 (1972): 100-107.

the world. However, due to the immense debt the company was in, plus a series of poor results, a number of groups including the Warner Music Group had to be sold.⁵⁷⁹

4.2. Positive Effect of Mergers and Acquisitions on Independents, Artists and Consumers?

The title to this section has a question mark because the positive effect of mergers and acquisitions is in doubt. There is a general principle stating that in an oligopolistic market, the larger companies need not necessarily conspire and be detrimental to the smaller players.⁵⁸⁰ Such markets can indeed be competitive. Recent analysis of the European Commission statistics proves that the majority of mergers are allowed for the very reason that not all mergers are harmful.⁵⁸¹ In theory, the positive effects of mergers are that the newly formed entity may increase efficiency by re-structuring their activities, plus the majority of joined entities are competitively neutral, or even beneficial for competition, as well as for consumers and thus they should be allowed to proceed. Also positively, merged entities may create synergies, improve, or create new products, and/or lower costs, consequently benefiting consumers. Even the new European Competition Merger Regulation (analysed in Chapter 5) emphasises that “many oligopolistic markets exhibit a healthy degree of competition.”⁵⁸² Given the above, the effects of whether or not the reduction of majors from five to four could be pro-competitive and the effects of mergers, particularly that of Sony and BMG, on independent labels, have to be explored.

It can be argued that having only four companies dominating the recorded music market produces marginalised competition. Competition that is challenging to the majors requires more than just a myriad of ‘bedroom’ independent labels. It cannot be said that majors force independents to exit the market but they do make independent companies’ existence more disadvantaged with the latter being unable to compete as aggressively.

⁵⁷⁹ *id.*, at p. 262. AOL and Vivendi also experienced similar problems to those described. See Enrique Bustamante, “Cultural Industries in the Digital Age: Some Provisional Conclusions,” *Media, Culture and Society* 26, no. 6 (2004): 813; and *The Economist*, “Lights! Camera! No Profits!,” January 16, 2003.

⁵⁸⁰ Alison Jones and Brenda Sufrin, *EC Competition Law: Texts, Cases and Materials* (Oxford: Oxford University Press, 2008), 1026.

⁵⁸¹ See the Commission’s statistics, <http://ec.europa.eu/comm/competition/mergers/statistics.pdf>.

⁵⁸² Council Regulation (EEC) No 139/2004, *supra*, n. 211, at para 25 of the Preamble (discussed in Chapter 5).

That perhaps explains the prevalent opinion concerning majors and independents; the majors are portrayed as predators, who pounce and acquire humble independents. This stereotypical assumption has never really been examined and therefore it was deemed necessary to investigate the truth of the matter during the interview stage. Interestingly, in answer to the following question: “Does the 75 percent of the market share held by majors worry you?”, every response was “No”. The answer to the question of: “Have you felt that the situation has worsened for the independents after the Sony/BMG merger?”, was a unanimous “No” too. Such indifference to the merger may be explained by the fact that independents consider that they operate in a different sphere. However, when confronted with the question of “Should Impala have opposed the Sony/BMG merger?”, the majority of the interviewees responded “Yes”.

The interviews also provided two opposite views on the impact that mergers have on independents. A series of responses could be grouped as “could not care less if they [majors] merge because it is not going to change anything for my label – the gap between majors and independents is too big already and we can not compete on the same terms anyway”.⁵⁸³ The other respondents thought that the fewer majors there were in the market, the more opportunities there were for independents because majors would concentrate on the commercial releases, whereas independents would fill in the diversity vacuum.⁵⁸⁴ Thus the latter line of responses conforms to Burnett and Lopes’ views (discussed in Chapter 1). Whilst certain interviewees could not think of any impact of acquisitions, others came up with the straight reply that majors have a *positive* impact on independents by acquiring them. This is a new approach to the problem of acquisitions, and therefore it deserves an explanation.

Keith Harris made an interesting point in that he was of the opinion that majors actually do a favour to independents by acquiring them.⁵⁸⁵ For example, after Andy McDonald sold his label Go! Discs to PolyGram, he had enough money to start a new and successful independent label, Independiente. Similarly, Alan McGee signed a licensing deal with Sony in order to receive enough funds to market the band Oasis via his label, Creation Records (for more see Chapter 3). The argument is that majors give

⁵⁸³ Interview with Safta Jaffery, *supra*, n. 391.

⁵⁸⁴ Interview with Geoff Travis, *supra*, n. 352.

⁵⁸⁵ Interview with Keith Harris, *supra*, n. 370.

independents enough funding to go and set up a new label and develop more talent. The argument has a certain degree of value but as always, there is another side to the coin.

In most cases, what is transformed during acquisition is the culture of independents with the resulting diminution of roster diversity.⁵⁸⁶ Marc Marot, ex-Managing Director of Island Records, gave a very interesting account of the issue.⁵⁸⁷ In 1984, Island Records found itself in a disastrous situation with huge debts (losing about £4.5m per year) and a large roster of artists. The then small major, PolyGram Records acquired Island Records and rescued it by introducing a new structure and intelligent management. With PolyGram's funding, Island could afford to sign stellar acts and reinvent U2, which made the label a very profitable entity.⁵⁸⁸ Therefore, at this point the argument that independents actually benefit from being acquired by majors is a valid one. However, when the biggest major label, Universal, acquired PolyGram from Phillips, a different reality prevailed. The root of the difference was that PolyGram was a European-centred company, whilst Universal was American-based. Universal introduced radical changes to both the structure and culture of Island. Prior to the acquisition, there were 67 singles released by Island run by a staff complement of 50. After the acquisition there were 211 singles released, with the same personnel of 50 people because the company had to double its turnover whilst reducing costs. On top of that, there was increased pressure on the label to develop American acts. Within a few years, Vivendi acquired Universal and they too wanted even more cost savings; achieved by selling properties and recording studios. This sequence of events had a deeply negative effect on the artistic community because the artists who were originally signed to an independent label did not necessarily fit the matrix that only required hits. Therefore, the answer to the question of whether mergers and majors have any positive effect on the small business in the record industry is not straightforward. Quite often what suffer the most are musical diversity and the artists themselves.⁵⁸⁹

⁵⁸⁶ For multiple examples of majors' artist roster diminution see David Park, *Conglomerate Rock: The Music Industry Quest to Divide Music and Conquer Wallets* (Plymouth: Lexington Books, 2007), 32.

⁵⁸⁷ The data below was provided by Marc Marot at MusicTank seminar, *supra*, n. 323.

⁵⁸⁸ PolyGram also saved from bankruptcy the legendary rap and hip-hop label Def Jam in 1994. Rob Sharp and Rebecca Armstrong, "Record Labels that Rocked Our World," *The Independent*, January 17, 2008.

⁵⁸⁹ For more on this see Negus, *supra*, n. 32, at pp. 359 – 379. According to Negus, each unit or genre can be categorised according to its performance and investment requirements. Negus cites the example of Capitol-EMI getting rid of its Urban division and sacking 18 staff members (mostly black). The company's argument was that it could then concentrate on other areas/genres (which happened to be white). There was a public outcry that the abandonment of this division within the company was racist as sales were relatively healthy. Thus, Negus made the point that companies also seek to control culture.

It is important to bear in mind that a large market share gives majors the opportunity to exercise their market power in unlawful ways as can be seen below. The next section will provide examples of anti-competitive behaviour by the majors and its effect on independent labels, artists and consumers.

4.3. Anti-Competitive Practices

“Dominant position is not a problem; it is the abuse of it which is.”

Patrick Zelnick⁵⁹⁰

This section describes anti-competitive practices in the context of what is defined as anti-competitive behaviour under European, UK, and US law. The section of the material covering the legal dimension of anti-competitive practices is dealt with in Chapter 5).

As mentioned earlier in this chapter, oligopolistic markets do not always lead to anti-competitive behaviour by the larger companies. However, there have been and still are, patterns of anti-competitive behaviour throughout the existence of the record industry. In response to those patterns, there have been numerous investigations into the operation of the record companies; some of them proving anti-competitive practices, some of them failing due to the lack of evidence. This section provides a number of examples of such behaviour⁵⁹¹ and its repercussions on small businesses.

In 1994, the then Monopolies and Mergers Commission⁵⁹² carried out an investigation into the record industry,⁵⁹³ and emphasised that a number of practices exercised by the then five major record companies, appeared to prevent, restrict or distort competition in the market of recorded music. The practices were as follows:

⁵⁹⁰ Quoting Patrick Zelnick, President of Impala at Music Industry Conference “London Calling”, 28 June 2007.

⁵⁹¹ Numerous sources have been written on some of the issues discussed below, particularly the recording contracts. For more information about the recording contracts see: Simon Garfield, *Expensive Habits: The Dark Side of the Music Industry* (London: Faber, 1986) and Steve Greenfield and Guy Osborn, *Contract and Control in the Entertainment Industry* (Dartmouth: Aldershot, 1998).

⁵⁹² Now known as the Competition Commission (UK).

⁵⁹³ Monopolies and Mergers Commission, “*The Supply of Recorded Music: A Report on the Supply in the UK of Pre-recorded Compact Discs, Vinyl Discs and Tapes Containing Music*,” June 1994. See also Tom Usher, “This Monopoly of Music.” *Entertainment Law Review* 6, no. 1 (1995): 27 – 31.

- (i) The adoption of similar pricing policies;
- (ii) The decline to license imports of some sound recordings; and
- (iii) Entering into recording contracts with artists, which include terms that restrict the artists' ability to exploit their talent fully and restrict competition in the supply of recorded music. For example, clauses relating to the extent of copyrights acquired, length of contract, exclusivity, options, obligations to exploit recordings, and royalty rates.

The following discussion will illustrate and critically analyse these and *other* practices.

4.3.1. Minimum Advertising Price and Minimum CD Price

In 2000 the Federal Trade Commission (hereinafter, FTC) carried out an investigation in the USA into the Minimum Advertising Price (hereinafter, MAP). Within this practice, majors forced retailers to keep prices artificially high by threatening to withhold millions in promotional money.⁵⁹⁴ Under MAP, retailers were forbidden to advertise CDs below an established minimum, at the risk of losing millions of promotional money from the record labels. In the FTC's view, these pricing policies constituted antitrust violations because they represented a form of price-fixing.⁵⁹⁵ FTC held that MAP policies, supported by every major, violated Section 5 of the FTC Act, as unreasonable restraints of trade under the so-called 'rule of reason',⁵⁹⁶ and that the MAP policies were illegal "facilitating practices which increase the risk of collusion or interdependent conduct by the market participants".⁵⁹⁷ The majors settled this case out of court.⁵⁹⁸

In 2002 and 2003, there were two further related investigations in which the USA antitrust authorities accused both majors and retailers of collusion in setting minimum

⁵⁹⁴ See *Federal Trade Commission*, "Record Companies Settle FTC Charges of Restraining Competition in CD Music Market." May 10, 2000.

⁵⁹⁵ The FTC estimates that U.S. consumers may have paid as much as \$480 million more than they should have for CDs and other music products because of the MAP policies over 1997 - 2000. *id.*

⁵⁹⁶ Discussed below in Chapter 6.

⁵⁹⁷ Statement of Chairman Robert Pitofsky *et al.*, "In the Matter of Time Warner; Sony Music Entertainment; Capitol Records, d.b.a. EMI Music Distribution; Universal Music & Video Distribution Corp. and UMG Recordings; and BMG Music, d.b.a. BMG Entertainment." File No. 971-0070.

⁵⁹⁸ Federal Trade Commission, *supra*, n. 595.

prices for CDs.⁵⁹⁹ Once again, both cases were settled out of court.⁶⁰⁰ An earlier case examining price-fixing by Warner and Universal to raise prices for the Three Tenors albums resulted in Warner too, settling the case, whilst Universal faced an administrative trial.⁶⁰¹

In the UK as well there was an investigation in 1994 into *The Supply of Recorded Music*, which found that music products were not unfairly priced.⁶⁰² However, three years later in Italy, the then five majors were fined for taking part in concerted practices that fixed standard wholesale prices.⁶⁰³

4.3.2. Price-Fixing of Downloads

In 2001 all five majors at the time set up their own two online music services: Pressplay (Sony and Universal) and MusicNet (Warner, EMI and BMG). These joint ventures caused numerous competition concerns.⁶⁰⁴ Firstly, those two services meant the then Big Five's ownership of a vast amount of copyrights in music, with the resultant freedom of what to do with their recordings. The majors were licensing their own music to their own digital distribution companies, thus controlling the pricing of music distribution on the Internet. Secondly, such a duopoly meant that majors could choose between either acquiring their competitors, or not licensing their music, thus driving them out of business. In the latter scenario, consumers were forced to subscribe to both services if they wanted content from all five majors, or go back to illegal downloading. The services also used competing audio formats and numerous restrictions. Despite the above, the Department of Justice's investigation found no evidence that MusicNet and Pressplay have harmed competition or consumers of digital music.⁶⁰⁵

⁵⁹⁹ Sarah Coffey, "Settlement in CD-Record Club Suit: Members to Get 75 Percent Discount after Charges of Price-Fixing," *CBS*, December 5, 2003; Joel Selvin, "CD Rebate, Anyone?" *San Francisco Chronicle*, February 23, 2003; and *Maine Attorney General*, "Attorneys General Win Antitrust Settlement in Lawsuit Alleging Pricing Conspiracy on Music CDs," September 30, 2002.

⁶⁰⁰ The majors settled the 2002 investigation for \$143 million. In agreeing to the settlement, the companies denied any wrongdoing.

⁶⁰¹ *Federal Trade Commission*, "FTC Charges Warner Music and Universal Music," July 31, 2001.

⁶⁰² The MMC Report, *supra*, n. 593.

⁶⁰³ *Associazione Vendomusica / Case Discografiche Multinazionali*, *supra*, n. 452.

⁶⁰⁴ For a good analysis see Cyrus Wadia, "The Department of Justice's Investigation into Online Music," *Cooper, White & Cooper*, January 1, 2005.

⁶⁰⁵ See Statement by Assistant Attorney General R. Hewitt Pate, "The Closing of the Digital Music Investigation," *The Department of Justice*, December 23, 2003.

The situation has drastically changed with the arrival of Apple iTunes. Suddenly, the power to set prices has slipped from the majors to Apple.⁶⁰⁶ Nevertheless, in 2006 the Department of Justice opened an antitrust probe into possible collusion by the majors in fixing prices for downloads on digital music shops such as Apple iTunes, Yahoo, Real Networks and Napster.⁶⁰⁷ Prior to 2009, individual tracks cost 99 cents in the USA and 79 pence in the UK and such price setting, country by country, alerted the competition authorities in the EU too.⁶⁰⁸ Analysts claimed that the majors were making up to 65 percent more revenue on digital downloads than on CDs despite an apparent reduction in manufacturing, distribution, and packaging costs.⁶⁰⁹ The majors argue that they are entitled to such a big profit share because they had invested heavily in the technology to make their music available online.⁶¹⁰ Even though the prices for physical products, such as CDs, have dropped in the past few years, majors have been insisting that downloads should be priced differently depending on the popularity of the songs and artists.⁶¹¹ Finally, in 2009, Apple gave in to the majors' demand for variable pricing of the songs on iTunes.⁶¹² This is likely to make the investigation into fixed prices of downloads redundant, but at the moment of writing, the investigation continues.

4.3.3. Parallel Imports

The *Supply of Recorded Music*⁶¹³ as well as the investigation by the Office of Fair Trading (hereinafter, the OFT) in 2002 on the *Wholesale Supply of Compact Discs* also

⁶⁰⁶ This is also confirmed by the Commission's second approval of the SonyBMG merger in 2007 (discussed below in Chapter 5). See also Tim Arango, "Despite iTunes Accord, Music Labels Still Fret," *The New York Times*, February 2, 2009.

⁶⁰⁷ Greg Sampson, "DoJ Investigates Alleged Price-Fixing of Music Downloads," *Jurist*, March 04, 2006; Bobbie Johnson, "US Opens Inquiry into Pricing of Music Downloads," *The Guardian*, March 4, 2006.

⁶⁰⁸ *European Competition Commission*, "Competition: European Commission Confirms Sending a Statement of Objections against Alleged Territorial Restrictions in On-Line Music Sales to Major Record Companies and Apple," 03 April 2007; Johnson, id.

⁶⁰⁹ Also cited in Dipesh Gadhur and Steven Swinford, "CD Makers Hike Price of Music Downloads," *The Sunday Times*, June 11, 2006.

⁶¹⁰ Majors also have to pay for downloads' patents, different aggregators and format providers as well as digital rights management (copy protection to prevent the piracy). Interview with Darrell Panethiere, 27 June 2007.

⁶¹¹ These requests made Apple's CEO Steve Jobs remark that: "If they (majors) want to raise prices, it's because they're greedy." See Johnson, supra, n. 607.

⁶¹² Brad Stone, "Making Sense of New Prices on Apple's iTunes," *The New York Times*, April 7, 2009; Joe Weisenthal, "Apple Relents on iTunes Pricing, Premium Tracks for \$1.29," *The Business Insider*, January 6, 2009; Hilary Lewis, "iTunes' Variable Music Pricing Begins April 7," *The Business Insider*, March 26, 2009.

⁶¹³ The MMC report, supra, n. 593 and Usher, supra, n. 593, at p. 28.

considered the issue of parallel imports.⁶¹⁴ It found evidence of various practices being used by some or all of the majors to limit parallel importing of CDs into the UK from other EU countries.⁶¹⁵ However, there was not enough evidence to show that majors were putting pressure on retailers not to import. Having said that, because the evidence was borderline, the OFT reserved the right to continue future monitoring of the industry.

4.3.4. Restrictive Contracts

According to the report by the Mergers and Monopolies' Commission, restrictive contracts could stifle and restrict competition not so much between majors and independents but in the *supply* of recorded music. Restrictive contracts could bind an artist to one label for a decade, which means that an artist could not join another label. Therefore, restrictive contracts too have to be considered under the notion of anti-competitive behavior.

In the past and in the present, record contracts⁶¹⁶ between a label and an artist have contained certain terms that have been considered unreasonable and in restraint of trade.⁶¹⁷ A few examples being: too long a duration,⁶¹⁸ insufficient exploitation commitments⁶¹⁹ and exclusivity.⁶²⁰ It must be noted that with regards to recording contracts, independent labels too, often include unfair terms.⁶²¹ However, there are independent labels that are democratic with their recording contracts, the so-called

⁶¹⁴ *Office of Fair Trading*, "The Wholesale Supply of Compact Discs." September 2002. For a more detailed discussion see Usher, *id.*

⁶¹⁵ Evidence included vertical agreements not to import, discounts, marketing and promotional support to retailers on the understanding that all CDs were purchased from the UK subsidiary of the major record company. The OFT also found evidence that retailers who had imported CDs *were* punished.

⁶¹⁶ For a good critique of the recording contracts see the MMC Report, *supra*, n. 593, at pp.97 – 100 and Guy Osborn and Steve Greenfield, "Understanding Commercial Music Contracts: The Place of Contractual Theory." *Journal of Contract Law* 23 (2007).

⁶¹⁷ See for example debate in *Panayiotou and Others v Sony Music Entertainment (UK) Ltd* (the George Michael case) [1994] EMLR 229. For more detailed information see also John Enser and David Zeffman, "The Impact of UK Competition Law on the Music Industry." *Entertainment Law Review* 4, no. 3 (1993): 67 – 72; Michael A. Smith, "Restraint of Trade in the Music Industry." *Entertainment Law Review* 5, no. 5 (1994): 182 – 187; Alan Courthard, "Panayiotou v Sony Music Entertainment (UK) Ltd Times, June 30, 1994 (ChD)," *Journal of Business Law* (1995): 414 – 422.

⁶¹⁸ *Silvertone Records and Zomba Music Publishers v. The Stone Roses and Gareth Evans* (1991) unreported; *Silvertone Records v. Mountfield* [1993] EMLR 152.

⁶¹⁹ *Silvertone Records v. Mountfield*, *id.*

⁶²⁰ *Schroeder Music Publishing Co. Limited v. Macauley*, [1974] 1 ALL ER 171 (although this case dealt with a publishing agreement).

⁶²¹ Miranda Sawyer, "It's No Way to Make a Living These Days," *The Observer*, February 17, 2008.

50:50 deals, when the record label shares the income equally with the artist. Some independents do not charge their artists for the album artwork, video clips, R & D charge,⁶²² packaging deductions,⁶²³ and they share the recording costs 50:50 with an artist. Obviously, these types of arrangements are much fairer to the artists.

In the infamous George Michael case against Sony,⁶²⁴ the former claimed that his contract was restrictive on the grounds of exclusivity (leaving him unable to sign to another record company); duration of the contract (potentially over 20 years); no artistic control over his recordings; no obligation on Sony to release any of his recordings and restrictions on recording after termination of the contract. This set of standard terms does not seem to be in neither the artist's nor the consumer's interests. In the past few years particularly, numerous discussions and initiatives sought to amend the standard terms of major record contracts, the most famous attempt being the new BMG contract, (reviewed in relation to copyright on page 128). However, at the moment of writing, no other major has stepped forward with the notion of introducing more democratic record agreements.

Another problematic area in record contracts, which restricts competition in the supply of music and impacts diversity, is the claiming back of copyright in the recordings by the artists from the record company. These days, the situation is slightly improved because record contacts often include release commitments, with the option for recordings to revert if these commitments are not met. Sometimes artists can buy back the masters by repaying the record company advances, or by paying an override royalty. Quite often though, the record company chooses to delete⁶²⁵ the works without providing an artist with the option to buy the masters back. Although the situation in relation to deleted works is improving in the digital age, this practice is still used by the majors. The problem affects both the artists and public overall. As a music industry insider working under Universal's regime revealed: "every month a computer-generated

⁶²² The majors introduced Research and Development charge when the CDs first appeared on the market. Interview with Mike Batt, *supra*, n. 343.

⁶²³ The R&D charge then was transformed into the 'packaging deduction' – a major reserves the right to charge its artists for any breakages of the CDs. This controversial deduction, described as a fallacy by Mike Batt, is applied to downloads too, even though there can be no physical breakage of a download.

⁶²⁴ *Panayiotou and Others v. Sony Music Entertainment (UK) Ltd*, *supra*, n. 617. George Michael lost the case as he previously voluntarily entered into the re-negotiated agreement with Sony, which provided him with a substantial remuneration.

⁶²⁵ Andrew Druckenbrod, "PSO discs see light of day again," *The Pittsburgh Post-Gazette*, June 03, 2007. Although the situation is slowly being rectified by the majors. See Owen Gibson, "Long-lost Tunes Dug up for Jukebox of the Net," *The Guardian*, January 19, 2006.

list would come in from Universal based purely on the lowest selling albums in the previous quarter, suggesting that they should be deleted. Sometimes we had to delete Bob Marley and Robert Palmer records because they were not selling in large numbers”.⁶²⁶ Independents too delete their old records because they cannot afford to manufacture titles that do not sell well. However, they are more willing to sell the copyrights back to the artist, or if the artist does not have the money to acquire the copyrights but would like to sell his songs on his website, an independent label may take a share of the sales. Such an approach seems more democratic compared to the outright deletion of works by the majors.

However, when the then MMC investigated the restrictive clauses in artists’ contracts, they were not found to be anti-competitive. The reasoning behind such a decision was that record companies *compete* with each other to sign both new and established artists, which gives artists adequate bargaining ability to negotiate the terms of their contracts.⁶²⁷ The position held by the MMC seems to be poorly researched as new artists, with a few exceptions, do not have enough bargaining power to negotiate better deals with majors. While the MMC accepted that clauses granting exclusivity to record companies do *restrict* competition, since they restrain an artist from releasing their material on other record companies, the MMC recognised that a certain degree of exclusivity was necessary for such contracts and it was noted that artists should seek remedies in the courts.⁶²⁸ Unfortunately, the MMC did not clarify what was the reasonable duration of ‘a certain degree of exclusivity’. What this shows, however, is that competition authorities are ready to consider restrictive contracts as a potential anti-competitive tool because they may disadvantage other labels and more importantly the artists as well as the consumers.

4.3.5. Payola

Historically, radio play has always been crucial to the record industry in terms of giving exposure to recordings. This section provides examples of majors’ anti-competitive behaviour in obtaining airplay.

⁶²⁶ Quoting Marc Marot at the MusicTank seminar, *supra*, n. 323.

⁶²⁷ The MMC Report, *supra*, n. 593, at pp. 28-9. See also Michael Trebilcock, *The Common Law of Restraint of Trade: A Legal and Economic Analysis* (Toronto: Carswell. 1986).

⁶²⁸ The MMC Report, *id.*, at p. 13.

It is extremely difficult to obtain airplay on mainstream radio stations such as BBC Radio 1 and Radio 2 in the UK,⁶²⁹ because quite often the radio stations restrict their choices to between 15 – 30 songs,⁶³⁰ which in turn leads to a further reduction of diversity. Numerous digital radio stations only partially address the issue; in terms of coverage, it is still important that recordings have exposure on mainstream radio. The most common way to obtain airplay is to hire a radio plugger, who will help the artist have his/her recordings heard for a fixed (usually significant) amount of money. There is, however, another way to obtain airplay. Payola (pay for play) signifies the practice whereby illegal payments are made to radio stations for airplay.⁶³¹ Payola in the record industry has existed for the past 45 years and has been well documented along with the fact of how deliberate opposition to pay radio stations nearly ruined the careers of groups such as the Pink Floyd⁶³² in the US. However, within the last two decades, bribes to radio stations have evolved into an elaborate corporate payola strategy, particularly in the US. With the significant consolidation of the radio industry, e.g. Clear Channel and Infinity Broadcasting, major record companies can, and do, negotiate deals for airplay across a large number of stations. The inducements for airplay may take several forms:

1. Bribes in the forms of expensive holidays and gifts to radio programmers.
2. Giveaway prizes for radio stations' audiences.
3. Payments covering operational expenses of the station.
4. Payments to ensure that certain records are played under the guise of advertising.

To conceal many of the payments to individuals and radio stations, fictitious 'contest winners' and documents are often used to make it appear as though the payments and gifts were going to radio listeners instead of station employees.

Just how important radio stations are to the majors can be viewed from the extract below taken from the correspondence between Epic Records and Infinity radio station:

⁶²⁹ Helienne Lindvall, "Behind the Music: The Politics of the Playlist," *The Guardian*, December 4, 2008.

⁶³⁰ Belifante and Johnson, *supra*, n. 368, at p. 19.

⁶³¹ This practice has recently become expensive even for the majors. See Eric Boehlert, "Record Companies: Save Us from Ourselves!" *Salon*, March 13, 2002.

⁶³² Dannen, *supra*, n. 213 and Alexander, *supra*, n. 172, at pp. 93 – 95.

“Epic Records has agreed to provide a Celine Dion promotion for each mainstream adult Infinity radio station. The promotion will consist of winner and guest from each market being flown roundtrip to Las Vegas for a Celine Dion performance at Caesar’s Palace. Epic Records will provide two nights hotel stay and tickets to the performance. There will be one grand prize (meet Celine, play Blackjack with Celine, have lunch with Celine) to be determined before the promotion airs. This e-mail also confirms each of the following stations has agreed to report “Goodbye’s” on October 28th, 2002”.⁶³³

Followed by,

“OK, here is it in black and white and it’s serious: if a radio station got a flyaway to a Celine Dion show in Las Vegas for the ad, and they are playing the song all in overnights, they are not getting the flyaway. Please fix the overnight rotations immediately”.⁶³⁴

These are perhaps some of the reasons why the ex-New York District Attorney General Eliot Spitzer initiated a payola investigation in 2005.⁶³⁵ This particular case was settled by the parties involved with Sony BMG⁶³⁶ paying \$10 million, Warner Music⁶³⁷ paying \$5 million, EMI \$3.75 million,⁶³⁸ and Universal paying \$12 million.⁶³⁹ These examples demonstrate that even though majors are fined heavily for this conduct, they still have a cavalier attitude to payola.

4.3.6. Marketing & Advertising Power

Marketing power as such does not represent anti-competitive behaviour. It is the way the power is used which can exclude other participants from the market and the resulting diminution of diversity that is in need of examination. The abuse of marketing power is included in this section because of the above concern.

⁶³³ *Office of the Attorney General*, “Sony Settles Payola Investigation,” July 25, 2005.

⁶³⁴ *id.*

⁶³⁵ See also Arshad Mohammed, “FCC Plans Payola Investigation,” *The Washington Post*, August 9, 2005.

⁶³⁶ See Attorney General of the State of New York in the Matter of Sony BMG Music Entertainment, “*Assurance of Discontinuance Pursuant to Executive Law § 63 (15)*”.

⁶³⁷ Attorney General of the State of New York in the Matter of Warner Music, “*Assurance of Discontinuance Pursuant to Executive Law § 63 (15)*”.

⁶³⁸ Greg Levine, “Hot Wax: Spitzer Says EMI Settles Payola Probe,” *Forbes*, June 15, 2006.

⁶³⁹ *id.*

The economies of scale and a 75 percent market share provide majors with another competitive advantage, namely enormous marketing and advertising budgets.⁶⁴⁰ For example, in 2004, Universal single-handedly cut its CD prices in the US. This price-cut was accompanied by a demand that retailers provide Universal with 32 percent of their shelf space.⁶⁴¹ Slashing the prices of CDs can already harm the livelihood of independents, let alone the purchase of one third of the available shelf space by one company. Additionally, buying up advertising space on TV, radio, in retailers and digital music shops, has become standard practice by the majors.⁶⁴² Even hugely successful independent labels like Dramatico in the UK cannot compete with majors in the run up to Christmas,⁶⁴³ e.g. majors can afford to book all their Christmas television advertising in May.⁶⁴⁴ The big four might not even know what records they are going to market, but they know that they will have enough catalogues to make TV advertising worthwhile during the run up to Christmas. Therefore, even if there is a successful record released by an independent in October, it is impossible for the company to provide a good marketing campaign because there are no advertising spaces left.⁶⁴⁵ For example, apart from the price cuts, in 2003 Universal single-handedly bought up all the advertising space on the French music channel TF1,⁶⁴⁶ thus blocking out not just independents, but other majors as well. This behaviour excludes smaller companies from the recorded music market and should, therefore, be dealt with under competition law rules.

Having shown the cultural and the economic importance of independent labels, and examples of anti-competitive practices exercised by the majors, it is now appropriate to analyse the past and existing jurisprudence *per se* in greater detail. The analysis is carried out in conjunction with a critical analysis of merger cases and regulations in both the US and the EU, but with particular emphasis of those in the EU.

⁶⁴⁰ John Vernon, *Market Structure and Industrial Performance* (Boston: Allyn and Bacon, 1972).

However, independents seek to change the situation. For example, their recent attempts to create a global rights licensing agency, Merlin, which collects income from ad-based online portals such as MySpace and YouTube. Andrew Orłowski, "Indies Unite to Challenge Big Four Digital Deals," *The Register*, January 20, 2000.

⁶⁴¹ Clare Matheson, "Mixing up the Music Industry," *BBC*, November, 19, 2003.

⁶⁴² See *Music Week*, "Universal and Asda Link up on TV Sponsorship Slots," June 6, 2005.

⁶⁴³ Interview with Mike Batt, *supra*, n. 343.

⁶⁴⁴ Interview with Keith Harris, *supra*, n. 370.

⁶⁴⁵ *id.*

⁶⁴⁶ Matheson, *supra*, n. 641. As Patrick Zelnick, President of Impala, put it: "In 2001 Universal bought 85 percent of TV advertising in France and 95 percent of TV advertising in December the same year." Music Industry Conference, London Calling, June 28, 2007.

Chapter 5: Past and Existing Jurisprudence in Merger Regulation

The previous chapters have looked at anti-competitive practices, the effect of mergers on independent labels and the importance of the diversity of producers for both economy and culture. These issues help provide the backdrop to examining the question of how applicable competition law has dealt with regulating the competitive dynamics between big and small businesses, and whether that law can help protect cultural diversity. This chapter will seek to demonstrate that both the application and interpretation of the merger regulation lack uniformity and that existing legal tests are not suitable for cultural industries.

The chapter is organised as follows. Firstly, a concise overview is provided of previous and new merger legislation relevant to the record industry. Past jurisdiction has to be considered because to date, all the record industry mergers within the EU have been decided by applying the old merger test. Following the overview, there are the analyses of the most influential mergers in recent years which had different merger tests and policy applied to them. Initially, an analysis of the Time Warner/EMI merger (EU approach) and the Warner/PolyGram (US approach) are provided. Such analyses, *albeit* brief, are necessary to highlight the crucial differences in the substantive tests between the two regulatory frameworks as well as to demonstrate how uncertain and unpredictable the legal regulation of the record industry has been. The analyses are followed by a detailed assessment of the merger between Sony and BMG. This particular merger was chosen because it has been one of the most important and controversial decisions on collective dominance since the decision in *Airtours* (see the discussion below). The analysis of the Sony/BMG merger will highlight the economic approach, on which both the merger test and existing jurisprudence are based and which were illustrated in the Commission's and Court of First Instance's rulings. The detailed analysis of the approval of the Sony/BMG merger in 2004, its annulment ruling by the CFI in 2006 and the second approval of the joint venture by the Commission in 2007, are necessary as a foundation for the ultimate debate about whether there should be a different legal regime for cultural industries, whether particular attention should be given to the issues of *non-price* competition, and whether competition law has so far

failed in preventing a high level of concentration in the record industry; and if so, whether the law itself needs to be changed.

The discussion contained in this chapter has largely been lacking in literature and practice to date. Those researchers who have worked in this field have reported back on specific areas only. This study takes the research further by showing that European Merger Regulation is not equipped with the tools to deal with cultural industries and suggestions to remedy the situation are detailed in the Conclusion.

5.1. EU Merger Regulation

As indicated in Chapter 1, the basis of competition law is that competition should be preserved because consumers benefit from competition through lower prices, better products, services and innovation. Therefore, it is crucial for any industry to keep producing at competitive levels. The task for overseeing competition matters in each Member State lies in the hands of the national authorities. The European Competition Commission is fulfilling this task in the EU.⁶⁴⁷ As discussed in Chapter 4, not all mergers are harmful, but some of them might give rise to anti-competitive behaviour, e.g. higher/fixed prices as well as diminished diversity, thus reducing both economic and consumer welfare. By definition, under joint ownership, financial interests and profit making of the parent companies are linked and become paramount. The parties to these joint ventures have a more fluid, transparent exchange and disclosure of information, including price information and other key factors. Such accessibility of information, therefore, is likely to reduce their incentives to compete aggressively with each other and if anything, increases the likelihood of collusion, which can affect their relevant market substantially. The above explains why merger regulations take seriously any claims about potential co-ordination mechanisms.⁶⁴⁸

Co-ordination between companies and their business practices may arise through an explicit cartel agreement,⁶⁴⁹ or via the presence of certain market characteristics that make the market conducive to *collective dominance*, the latter exemplifying tacit

⁶⁴⁷ The Antitrust Division and the Federal Trade Commission fulfil this task in the USA.

⁶⁴⁸ See for example, Case IV/M.190 - *Nestle/Perrier* [1992] L 356; Case IV/M.619 - *Gencor/Lonrho* [1997] OJ L 11; and Case IV/M.1524 - *Airtours/First Choice* [1999] OJ C124/10.

⁶⁴⁹ For an explicit collusion to take place there needs to be an agreement to either fix prices or to divide the market. See Jones and Sufrin, *supra*, n. 580, at p. 859.

collusion. Tacit collusion or tacit co-ordination can be defined as a co-ordinated outcome that emerges from companies' non-cooperative strategies, i.e. there is no need for a formal agreement between the companies, as is necessary in the case of an explicit cartel. Such conduct by the companies is therefore more difficult to spot by the competition authorities.⁶⁵⁰

In 1989 after a long history of failed proposals by the European Commission, the European Council adopted the European Community Merger Regulation (hereinafter, the ECMR) 4064/89.⁶⁵¹ Until 2000, the Commission had a great record of case-management with only one case being annulled by the CFI. After 2000 however, some cracks started to appear in the Commission's application of the merger regulation as the CFI annulled three high-profile decisions.⁶⁵² The annulments triggered adverse public criticism to which the Commission reacted by carrying out a review of the quality of its decision-making followed by a Green Paper on the Reform of Merger Control,⁶⁵³ which recommended the introduction of a *new* merger test. On 1 May 2004, the Commission adopted a new ECMR, which now regulates all mergers in the European Union.⁶⁵⁴ Simultaneously, the Commission has also adopted Guidelines on the Assessment of Horizontal Mergers, which covers both single and collective dominance.⁶⁵⁵

Since all previous mergers have been considered under the old ECMR, it is necessary to look at the old substantive test first in order to compare it to the modified test in the new ECMR to see what changes, if any, the new test can bring to the already highly concentrated record industry. The old regime is also important because the European

⁶⁵⁰ *id.*

⁶⁵¹ Council Regulation (EEC) No 4064/89 of December 21, 1989 on the Control of Concentrations between Undertakings [1989] OJ L395 as amended by Council Regulation (EC) No 1310/97, [1997] OJ L 180, hereinafter the 'Old ECMR'. The ECMR ensures that mergers and acquisitions are investigated either by the European Commission or by one or more national courts but never at both the EU and national level. Any transaction that exceeded thresholds defining a 'Community dimension' is investigated only by the European Commission, and not by national authorities. Commission decisions can be appealed in the Court of First Instance and the European Court of Justice.

⁶⁵² Case T 342/99 - *Airtours v. Commission* [2002] ECR II-2585; Case T 310/01 - *Schneider Electric v. Commission* [2002] ECR II-4071; and Case No COMP/M.2416 - *Tetra Laval/Sidel* [2004] OJ L 43 13.

⁶⁵³ Green Paper on the Review of Council Regulation (EEC) No 4064/89, COM (2001) 745/6 of December 11, 2001.

⁶⁵⁴ Council Regulation (EC) No 139/2004 of January 20, 2004 on the Control of Concentrations between Undertakings [2004] OJ L 24, hereinafter the 'New ECMR'. For more information on EU merger policy see John Vickers, "Merger Policy in Europe: Retrospect and Prospect." *European Competition Law Review* 7 (2004): 455 – 463.

⁶⁵⁵ Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Undertakings [2004] OJ (C31) 5. The guidelines focus on the following elements: the possible anti-competitive effect of horizontal mergers, buyer power, barriers to entry, market shares and introduce the consumer welfare-price standard.

Competition Commission will still consider new cases based on the previous thirteen years of case law.

5.1.1. The Old ECMR (Collective Dominance Test)

Under the old ECMR, regulatory intervention in pending mergers was warranted only on the satisfaction of the test set out under Article 2(2), which provided that:

“A concentration which *creates or strengthens a dominant position* as a result of which *effective competition would be significantly impeded* in the common market or in a substantial part of it shall be declared incompatible with the common market”(emphasis added).

As the wording suggests, dominance was the substantive test under the old ECMR. The uncertainty of this test begins with the concept and definition of collective dominance. Some scholars argue to this date about what is meant by the words ‘collective’ and ‘dominance’. The case law has brought in clearer ideas on that issue. In *Continental Can* the Commission defined ‘dominance’ as follows:

“Undertakings are in a dominant position when they have the power to behave independently, which puts them in a position to act without taking into account their competitors, purchasers or suppliers. That is the position when, because of their share of the market, or of their share of the market combined with the availability of technical knowledge, ...or capital, they have the power to determine prices or to control production or distribution for a significant part of the products in question. This power does not necessarily have to derive from an absolute domination permitting the undertakings which hold it to eliminate all will on the part of their economic partners, but it is enough that they be strong enough as a whole to ensure to those undertakings an overall independence of behaviour, even if there are differences in intensity in their influence on the different partial markets.”⁶⁵⁶

In terms of interpreting the notion of ‘collective’, it has been seen to include the situation where two or more undertakings are united by such economic links that together they hold a dominant position *vis-à-vis* the other operators on the same market,⁶⁵⁷ or *vis-à-vis* their competitors, their trading partners and consumers on a particular market.⁶⁵⁸

⁶⁵⁶ Case 6/72 [1973] ECR. 215, at para. 11.3.

⁶⁵⁷ *Societa Italiano Vetro SpA* [1990] 4 C.M.I.R 535.

⁶⁵⁸ *Compagnie Maritime Belge NV v. Commission* [2000] All.E.R 385. For more on the definition of collective dominance see Russel Richardson and Clive Gordon, “Collective Dominance : The Third Way?” *European Competition Law Review* 10 (2001): 416 – 423.

5.1.2. Airtours Decision: Tripartite Collective Dominance Test

Many assumed that the understanding and application of the collective dominance test would become easier after the seminal decision in *Airtours v. Commission*,⁶⁵⁹ which set a new tripartite collective dominance test and *raised* the standard of proof required of the Commission in order to block a merger.

Although the Airtours case related to the travel industry, it is important to examine it in the context of this study, as it raises many relevant points of reference and comparison for the record industry. In this case, the market for short-haul foreign package holidays was shared between four major short-haul travel companies and the fringe or small travel companies, which could be seen as being akin to major record companies and the independent record labels, respectively. The main fear was that two of the major companies and a newly merged company would foster tacit collusion and subsequently create a collective dominant position in the market. Initially, the Commission blocked the merger.⁶⁶⁰ However, Airtours then brought an appeal in the CFI, which reversed the decision of the Commission and made the test for collective dominance very difficult to satisfy. The CFI ruling⁶⁶¹ stated that, in order to establish a collective dominant position, the companies had to have a common understanding about the terms of co-ordination and that the following three conditions had to be satisfied:

- 1) Sufficient *market transparency*, i.e. the coordinating companies must be able to monitor the way in which the other company's market conduct is evolving.
- 2) To be sustainable over time, collusion needs a punishment mechanism that can deter a company from deviation, i.e. there should be some form of a *retaliatory mechanism*.

⁶⁵⁹ *Airtours v. Commission*, supra, n. 652. For more academic debate about this seminal case see for example, Ali Nikpay and Fred Houwen, "Tour de Force or a Little Local Turbulence? A Heretical View on the Airtours' Judgment." *European Competition Law Review* 24, no. 5 (2003): 193 - 202; Peder Christensen and Valerie Rabassa, "The Airtours Decision: Is There a New Commission Approach to Collective Dominance?" *European Competition Law Review* 22 (2001): 227 - 237; Heiko Haupt, "Collective Dominance under Article 82 EC and EC Merger Control in the Light of the Airtours Judgment." *European Competition Law Review* 23 (2002): 434 - 444; Massimo Motta, "EC Merger Policy and the Airtours Case." *European Competition Law Review* 21 (2000): 199 - 207; and Niels, supra, n. 105, at pp. 168 - 172.

⁶⁶⁰ See supra, n. 648.

⁶⁶¹ *Airtours v. Commission*, supra, n. 652, at para 62, and para 195 with respect to the retaliatory mechanism.

- 3) The reaction of both current and future competitors not participating in the co-ordination, as well as customers, should not jeopardise the results expected from the co-ordination.

The Court also insisted on the cumulative nature of these conditions and specified that the Commission must conduct a thorough market investigation and base its conclusion on fact rather than speculation, i.e. it is the clear *evidence* of this that counts, not just the mere theory. This again signals that, from *Airtours v. Commission* and onwards, the Commission will be looking for a very detailed economic analysis of the market in merger cases, i.e. economic evidence should be the crux of every decision. In this respect the question arises as to how relevant is the economic analysis for cultural industries? As shown in Chapter 1, there is a strong and undeniable connection between culture and economics, which is expressed in the term ‘cultural industries’. That being the case, the next section will highlight the difficulty of using economic tests in the cultural sphere and recognising the nuances of cultural industries. This will help demonstrate, in the Conclusion, that assessing *only* economic data in terms of cultural industries so far has not prevented high record industry concentration, which further supports the argument in favour of the need for a new cultural test, also highlighted in the Conclusion.

5.1.3. Economic Approach

Following the CFI’s ruling in *Airtours*, a new position of Chief Competition Economist was created within the Directorate-General for Competition (hereinafter, DG Comp) along with an accompanying staff of 10 PhD industrial economists. The intention of this was to provide the system with appropriate ‘checks and balances’ as well as ensuring access for the Commission to some form of qualified, independent opinion.⁶⁶² Overall, the aim of the increased emphasis on the economic evidence was to create more legal certainty and predictability. Introducing a more economics based approach also put European competition legislation closer in line with the US competition legislation (see further the discussion below).

⁶⁶² Sven B. Volcker, “Mind the Gap: Unilateral Effects Analysis Arrives in EC Merger Control.” *European Competition Law Review* 7 (2004): 405 – 407.

Whilst playing a significant role in certain cases,⁶⁶³ the economic approach seems less relevant in certain other cases, particularly those involving cultural industries, and as the practice has shown, the economics-based analysis has its problems. In current practice, the Chief Economist's staff joins a case only at Phase II, so they have to rely on the data submitted by the parties,⁶⁶⁴ thus they are not able to fully participate in the investigation from the outset.⁶⁶⁵ Additionally, the high-tech economic-approach and analysis is very costly,⁶⁶⁶ leads to more bureaucracy at the Commission,⁶⁶⁷ and is often uncertain too.⁶⁶⁸ Since economics is not an exact science, the economic approach has the added disadvantage of resulting in disagreement between economists themselves.⁶⁶⁹ As noted by Schmalensee: "economists cannot testify with the confidence of experts on ballistics or fingerprints – or at least they should not".⁶⁷⁰ However, arguably the biggest danger with an economic approach is that it is built on theoretic models, namely game-theory models.⁶⁷¹ Some of these theories clash with each other, thus producing different outcomes. Some scholars would even argue that these theoretic economic models are "sensitive to the underlying assumptions."⁶⁷² It is not clear which particular model the DG Comp may choose for any particular case and it further raises the question as to how *valid* and *relevant* this particular model is for the industry being considered. These matters, in turn, have important repercussions affecting the degree of predictability of the Commission's practice. Some argue⁶⁷³ that the more economic approach may create less legal certainty, while there is also debate as to the quality of the decision-making involved in these processes. Thus, it can be concluded that the use of economic evidence does not provide an all-encompassing solution, particularly in respect of

⁶⁶³ *New York v. Kraft Gen Foods, Inc.* 926 F.Supp. 321 (S.D.N.Y. 1995).

⁶⁶⁴ The discussion below of the Sony/BMG merger demonstrates how inconsistent the data collected by the parties can be.

⁶⁶⁵ Volcker, *supra*, n. 662, at p. 406.

⁶⁶⁶ Arndt Christiansen, "The 'More Economic Approach' in EU Merger Control." *Cesifo Forum* 1 (2006): 36 - 37.

⁶⁶⁷ Pursuant to Article 3(2) of the Implementing Regulation, the merging parties must submit the official notification form and all documents in 35 copies as compared with 24 and 19 copies previously.

⁶⁶⁸ Arndt Christiansen, *supra*, n. 666, at p. 39.

⁶⁶⁹ Arndt Christiansen, "The Reform of EU Merger Control – Fundamental Reversal or Mere Refinement?" *Social Science Research Network* (2006): 40. For more on the economic approach see Michael Utton, *Market Dominance and Antitrust Policy* (Cheltenham: Edward Elgar, 2003), 3 – 27.

⁶⁷⁰ Richard Schmalensee, "Horizontal Merger Policy: Problems and Changes." *Journal of Economic Perspective* 1, no. 2 (1987): 42. Also cited in Christiansen, *id.*

⁶⁷¹ Massimo Motta, *Competition Policy. Theory and Practice* (Cambridge: Cambridge University Press, 2004), 124 – 134.

⁶⁷² Ben Dubow *et al.*, "Unilateral Effects and Merger Simulation Models." *European Competition Law Review* 25, no. 2 (2004): 117.

⁶⁷³ Arndt Christiansen, *supra*, n. 666, at p. 39.

cultural industries, which are not purely about economics (see the detailed discussion below).

5.1.4. The New ECMR (Significant Impediment of Effective Competition)

Having considered the old merger regulation and test, it is now appropriate to examine the modifications carried out to arrive at the new test.

Article 2 (2) of the new ECMR provides for a new substantive test, which is the *significant impediment of effective competition* (hereinafter, SIEC):

“A concentration which would *significantly impede effective competition*, in the common market or a substantial part of it, in particular as a result of the *creation or strengthening of a dominant position*, shall be declared incompatible with the common market” (emphasis added).⁶⁷⁴

The above wording underlines a certain degree of convergence between the EU and the US substantive tests (see below the outline of the US test). The need for such convergence was highlighted by the case of *GE/Honeywell*⁶⁷⁵ where the EU and the US authorities viewed the competitive effects in very different ways, resulting in opposite outcomes. The US authorities approved the merger of *GE/Honeywell*, whilst the Commission under the old ECMR rejected the proposed transaction. Another supporting factor for the introduction of the new test was the gap⁶⁷⁶ between the application of the old test that existed as regards single dominance and collective dominance situations. Arguably, the old test, based on the concept of single dominance, was not equipped to deal with the gap between a single dominance and the situation when large companies merge *without* creating or strengthening a dominant position.⁶⁷⁷ In theory, the new test closes a loophole with regards to anti-competitive mergers in oligopolistic markets falling below the dominance market threshold.

⁶⁷⁴ For more analysis of the new test see Andreas Weitbrecht, “EU Merger Control in 2004 - an Overview.” *European Competition Law Review* 26, no. 2 (2005): 67 - 73 and Trevor Soames and Sylvie Maudhui, “Changes in EU Merger Control.” *European Competition Law Review* 26, no. 1 (2005): 57 - 64.

⁶⁷⁵ Case No COMP/M.2220, *GE/Honeywell* [2004] OJ L48, 1.

⁶⁷⁶ Simon Baxter and Frances Dethmers, “Unilateral Effects Under the European Merger Regulation: How Big Is the Gap?” *European Competition Law Review* 26, no. 7 (2005): 380 - 389.

⁶⁷⁷ *id.*

The new test was constructed differently from the old ECMR, which had presented a two-part test: “a concentration which creates or strengthens a dominant position as a result of which effective competition would be significantly impeded”. The new ECMR, however, provides a reversal in the threshold emphasis, effectively turning the order of the test around. Some scholars⁶⁷⁸ insist that the new substantive test represents a fundamental change in the EU merger regulation policy. However, the prevailing opinion⁶⁷⁹ is that the new test is unlikely to change the Commission’s approach because it still preserves the dominance test. Proving this point, the Commission has stated that the case law of the old ECMR would remain relevant under the new merger test:

“By keeping the concept of dominance unaltered, the new test will preserve the *acquis* and, thus, the guidance that can be drawn from past decisional practice and case law. As a result, previous decisions and judgments could still be relied upon as precedents when considering whether a merger is likely or not to create or strengthen a dominant position”.⁶⁸⁰

The Commission too has expressed its thoughts on the new test:

“Although it does not alter the Commission’s approach to the analysis of the competitive impact of mergers, the wording of the new test focuses unambiguously on the impact of a merger on competition. At the same time, it is a truly ‘European’ solution, combining the best of the substantive standards in our various jurisdictions, and preserving existing precedent, in the form of past Commission decisions and past judgments of the European Courts. Even if it can be expected that the Commission will, from now on, focus more on the competitive harm of a proposed transaction rather than on the dominance issue, its decision practice *should not dramatically change*, since it had already interpreted the dominance test in such a way that the market power issue was the main focus of its assessment” (emphasis added).⁶⁸¹

Only future cases will demonstrate whether the new test is a profound change or a reworded version of the old test.

⁶⁷⁸ Michael G.Egge *et al.*, “The New EC Merger Regulation: A Move To Convergence.” *Antitrust* (Fall 2004): 37.

⁶⁷⁹ See for example, Stephen Hornsby, “*European Merger Control – Can Enhanced Merger Control Solve the Oligopoly Problem?*” January 30, 2004.

⁶⁸⁰ See Philip Lowe, “Implications of the Recent Reforms in the Antitrust Enforcement in Europe for National Competition Authorities.” Speech at Italian Competition/Consumers Day, Rome, December 9, 2003. Also cited in Baxter and Dethmers, *supra*, n. 676, at p. 380.

⁶⁸¹ Linsey McCalum and Nicola Pesaresi, “Merger Review Package in a Nutshell.” *Competition Policy Newsletter* (2004): 2.

5.2. US Merger Regulation Test (Substantial Lessening of Competition)

This thesis is concerned with commentary and examination of two competition frameworks, namely that of the EU and the US. As such, it is important to outline the US merger test in order to highlight some of the key differences between its interpretation and application as compared to the EU (both old and new) merger tests, and to also identify which test is better suited to deal with cultural industries.

The antitrust law in the USA, which is relevant to the mergers in the record industry, is found in Sections 1 and 2 of the Sherman Act and Section 7 of the Clayton Act. Section 1 of the Sherman Act outlaws all contracts, combinations and conspiracies that unreasonably restrain interstate trade, including price-fixing and Section 2 deals with monopolies. Section 7 of the Clayton Act prohibits mergers or acquisitions that are likely to substantially lessen competition:

“No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital...of another person engaged also in commerce or in any activity affecting commerce, where ... the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly”.⁶⁸²

This wording of Section 7 has formed the basis of the US substantive merger test, in terms of the ‘substantial lessening of competition’ (hereinafter, SLC), which is successfully used as a merger test not only in the US but in other countries as well, e.g. Canada, Australia, UK and Ireland. The SLC test is even more economics-oriented than the dominance test (the latter being more of a legal nature),⁶⁸³ and its meaning and application are likewise not entirely certain. Throughout its existence, the SLC test underwent different interpretations from “an increase in the market concentration and a reduction in the number of competitors to a loss of opportunity for small business or a reduction of local control over business”.⁶⁸⁴ However the main difference between the

⁶⁸² Clayton Act, 15 U.S.C.

⁶⁸³ Makan Delrahim, “Antitrust Enforcement in the Entertainment and Media Industries.” December 18, 2003. Speech presented at the Recording Artists’ Coalition, Los Angeles, at p. 7; Giuseppe Tesaro, “The Evolution of European Competition Law and the Italian Autorita Garante della Concorrenza e del Mercato,” in *The Evolution of European Competition Law: Whose Regulation, Which Competition?*, ed. Hanns Ullrich (Cheltenham: Edward Elgar, 2006), 78.

⁶⁸⁴ Gabriele Stirati, “The Appraisal of Collective Dominance and Efficiency Gains under the Substantive Test of the New EU Merger Regulation.” *Erasmus Law and Economics Review* 1, no. 3 (2004): 280.

two tests is that the EU dominance test concentrates on the creation or strengthening of the dominant position, whereas the SLC test concentrates on how much competition is lost as a result of the merger.⁶⁸⁵

Initially, the Green Paper produced by the Commission recommended the adoption of the SLC test as it could be closer to the spirit of the economically based analysis undertaken in merger control and less legally rigid than the dominance test.⁶⁸⁶ This recommendation was also influenced by the fact that the US competition authorities provided a large number of consultations and commentary for the Green Paper. Nevertheless, the Commission opted out of adopting the SLC test, because as shown earlier, it would have undermined the existing body of case law built up on the dominance test. Once again political pressure affected matters and a compromise had to be found between the Commission and the Member States.⁶⁸⁷ It is yet to be seen to what extent, if at all, the new ECMR resembles the SLC test in practice.

Having looked, in brief outline, at the legislative framework of EU and US merger control, there now follows a discussion in the next section on the way in which the relevant competition authorities have applied existing legislation to recent mergers in the record industry.

5.3. Mergers in the Record Industry

The record industry has always been subject to numerous mergers and acquisitions, as outlined earlier in Chapter 3. The critical analysis below will investigate how European merger regulation was, and is dealing with cultural issues in relation to the record industry. The analysis will look at certain classic cases in the area and their different interpretation by different courts. Having done that, it will then review the competition law in terms of the record industry, and show why the European merger test utilised in

⁶⁸⁵ Vickers, *supra*, n. 654, at p. 455.

⁶⁸⁶ Green Paper on the Review of Council Reg. 4064/89 COM (2001) 745/6. December 11, 2001, at para 165. Not all scholars agree, however, that the SLC test is better than the SIEC test. Some argue that they are very similar, but the competition authorities in the EU and the USA have different emphasis on the evaluation factors, e.g. market shares, market concentration, entry barriers, countervailing power etc. See Ulf Boge and Edith Muller, "From the Market Dominance Test to the SLC Test: Are There Any Reasons for a Change?" *European Competition Law Review* 10 (2002): 496.

⁶⁸⁷ Christiansen, *supra*, n. 669, at p. 20.

these cases was inappropriate for the record industry. For consistency and to avoid focussing only on the Sony/BMG merger, the analysis also considers how both the EU and the US competition authorities dealt with some other mergers between major record companies in the past.

5.3.1. Time Warner

The examples of two mergers involving the Warner Records group illustrate that competition law may have the relevant tools to prevent high concentration of the record industry. Throughout its long history, Warner Records has attempted several times to merge with other companies, notoriously failing twice. The Federal Trade Commission (hereinafter, FTC) in the USA blocked Warner's first merger attempt with PolyGram in 1984.⁶⁸⁸ The second merger with EMI was withdrawn from the European Commission in 2000 amid the parties' fears that it would be blocked. The analysis below demonstrates how both merger attempts were treated by the US and EU competition authorities, and how legal regulation is viewed and interpreted with uncertainty within the record industry.

5.3.1.A. Warner/PolyGram (US Reasoning)

At the time of the first merger attempt in 1984, Warner was the second largest music label in the US, whilst PolyGram was the sixth largest and experiencing financial problems. Unlike in the Sony/BMG merger plan, Warner/PolyGram proposed a joint venture to record and *distribute* their music.⁶⁸⁹

The United States Court of Appeals noted that the factors to consider when determining impact on competition included "market shares of merging firms, industry trends towards concentration, degree of concentration within the industry, prior mergers by firms in question, and barriers to entry in the industry".⁶⁹⁰ It is worth noting at this stage that such matters have not been considered in the Sony/BMG rulings. The Court

⁶⁸⁸ *Federal Trade Commission v. Warner Communications* 742 F. 2d [1984] 1156 - 1165.

⁶⁸⁹ PolyGram intended to close down its distribution operations in the US, so that a new joint venture would distribute the records of both companies. For circumstances surrounding the Warner/PolyGram merger see Qualen, *supra*, n. 336, at pp. 17 – 20.

⁶⁹⁰ *Federal Trade Commission v. Warner Communications*, *supra*, n. 688, at para 13.

considered Section 7 of the Clayton Act as well as Section 13 (b) of the Federal Trade Commission Act, the latter of which provides that a merger will be allowed if it is in the *public interest*. Further, it is important to note that the notion of public interest has never been mentioned in any of the Sony/BMG rulings. The Court of Appeals noted that the main issue was “not to make a final determination on whether the proposed merger violates Section 7, but rather to make only a preliminary assessment of the merger’s impact on competition”.⁶⁹¹ In this case the Court wanted to assess the impact of this potential merger on competition in the future. This contrasts with the seemingly more stringent tripartite dominance test encountered in the *Airtours* case. At the time of the Warner case, in the mid 80s, the recorded music market was moderately concentrated. However the Court of Appeals already saw a trend towards increased concentration, noting that the proposed joint venture would present “serious, substantial, and difficult questions with respect to its anti-competitive effects”.⁶⁹²

Most importantly, it was emphasised that if the merger were completed, the new venture’s market share would be 26 percent, whereas the total market share of the top four record companies was 75 percent. At this stage, it is worth noting that the combined market share of Sony/BMG following the merger in 2004 was about 25 percent. Due attention was also given to the increased concentration amongst record distributors, disadvantages in obtaining airplay and substantial barriers to entry. Therefore, the Court of Appeals found it necessary to assess those non-price issues. Moreover, the judgment in the Warner/PolyGram case set out that *financial weakness* in itself did not justify a merger with another record company.⁶⁹³ That again is in crucial contrast to the parties’ reasoning for the Sony/BMG decision (as set out in the discussion below). The Court of Appeals re-iterated that the antitrust laws did not protect competitors, even if those competitors feared that they might as a result be forced from the market, showing that the antitrust law protects competition, rather than competitors. Finally, the Court considered public interest factors, for example beneficial economic effects and pro-competitive advantages for consumers. After considering all the above criteria, the Court blocked the merger. At this stage, it is important to bear in mind that although the US Court used broad criteria to assess the

⁶⁹¹ *id.*

⁶⁹² *id.*, at para, 15.

⁶⁹³ *id.*, at para 16. At the time, the American branch of PolyGram was losing \$300,000 a day. See Qualen, *supra*, n. 336, at p. 18.

impact of the proposed merger on *competition*, no mention was made about culture or cultural diversity.

5.3.1.B. Warner/EMI (EU and US Reasoning)

This particular merger provides a good illustration of how competition authorities may carry out a thorough market investigation (which is only partially witnessed in the Sony/BMG merger investigation). In 2000, EMI and Time Warner⁶⁹⁴ notified the Commission of their agreement to combine their music business, including music publishing, on-line distribution and retail distribution.⁶⁹⁵ During the early stages of investigation, the Commission reached the conclusion that the transaction should be prohibited for a number of reasons. Firstly, the Commission pointed out that the market was already highly concentrated (with the majors holding around 80 percent of the market share), and the merger would create a collective dominant position in the EU. Interestingly, when considering the Sony/BMG merger in 2004 and 2007, the Commission was not perturbed by the fact that the four majors together held 75 percent of the market share at that point. Secondly, the merger between Warner and EMI would have raised a single dominance issue in the market for music publishing,⁶⁹⁶ because the newly formed entity would have had a resultant market share of over 30 percent and in some cases as high as 75 percent in almost all EU Member States. It is unclear whether the Commission was disturbed by the potentially high concentration of copyrights held by just two players or whether there were a number of vertical issues in music publishing caused by the AOL/Time Warner deal,⁶⁹⁷ but nevertheless the music publishing was one of the most important criteria, which led to the subsequent withdrawal of the merger. Another fear was that the new entity would have been between 2 to 5 times bigger than its next competitors (Universal, BMG or Sony).

⁶⁹⁴ Case COMP/M. 1852 - *EMI/Time Warner*, aborted on October 5, 2000.

⁶⁹⁵ See *European Competition Commission*, "Commission Opens Full Investigation into Time Warner/EMI merger". June 14, 2000. For more information see Soetendorp and Kretschmer, *supra*, n. 167, at pp. 56 – 59; Valerie Rabassa, "Joint Ventures as a Mechanism that May Favour Co-Ordination: An Analysis of the Aluminium and Music Mergers." *European Competition Law Review* 25, no. 12 (2004): 771, 778, and Valerie Rabassa, "The Commission's Review of the Media Merger Wave." *Competition Policy Newsletter* 1 (2001): 46 – 52.

⁶⁹⁶ Rabassa (2004), *id.*, at p. 778.

⁶⁹⁷ COMP/M.1845 - *AOL/Time Warner Case*, October 11, 2000. Vertical issues arose because with control of both Time Warner and EMI music content, AOL could have been in a position to favour Time Warner/EMI content at the expense of other record companies. The merger between Time Warner and EMI along with AOL's existing structural links with BMG, would have given AOL control over about half of the EU music content available for on-line delivery. Rabassa (2004), *id.*, at p. 778, and Molly Boast, "Report from the Bureau of Competition." *Federal Trade Commission*, March 29, 2001.

In its initial investigation stage, the Commission produced a list of the following factors to be taken into account when considering whether the merger was likely to be anti-competitive:

- a. TimeWarner was the ‘maverick’⁶⁹⁸ of the market, the removal of which would have significantly changed the incentive to compete effectively. It seems that the Commission adopted the common view that maverick firms could be good at forcing competition in a given market. Therefore, the argument is that if TimeWarner merged with EMI, the former would have had less incentive to compete in the recorded music market.⁶⁹⁹
- b. TimeWarner/EMI could have consolidated their structural links with the other majors through distribution agreements and album compilations. That, in turn, could result in fewer opportunities for small labels to break into the market.⁷⁰⁰
- c. The majors would have had little incentive to deviate from their co-ordinated behaviour because of market transparency and retaliatory measures, for example, withdrawing a deviator from the highly profitable compilation deals. Thus, the Commission was already aware of the retaliatory measures in the record industry, and this is important to bear in mind for the following analysis of the Sony/BMG merger.
- d. The recorded music market would have become more transparent as the number of majors would decrease. This is also an interesting point as in the Sony/BMG merger, the Commission did not find that the reduction in major labels from 5 companies to 4 would lead to higher transparency within the market.
- e. Another important factor in rejecting the merger proposal was that *small and new independent music labels* as well as the *consumers* would not be able to challenge the collusion. This is the only opinion that the Commission has not changed in the second approval of the Sony/BMG joint-venture (see below).

⁶⁹⁸ See the glossary for the definition of ‘maverick’.

⁶⁹⁹ However, this is not a clear-cut issue. For the effect of maverick firms in merged entities see Malcolm B. Coate and Andrew N. Kleit, *The Economics of Antitrust Process* (Massachusetts: Kluwer, 1996), 49.

⁷⁰⁰ It is not known whether the Commission had considered the impact of the proposed merger on cultural diversity. There is no mention of it in the Commission’s Press Release.

In their desire to merge, the companies even offered to sell record labels, music catalogues and distribution networks to meet the Commission's concerns, but this was to no avail. Bearing in mind the above concerns of the Commission, the parties withdrew their merger application.

In the USA, the FTC reached the same conclusion although it used *different* criteria. Firstly, the competition authorities in the US stated that the recorded music market was already highly concentrated. This is also important to bear in mind when discussing the US reasons for allowing the Sony/BMG merger in 2004 (see below). Secondly, a clear point was made about the proposed merger increasing the co-ordinated behaviour among the majors. As for the structural links, it was noted that the recorded music market was ruled by "a tight oligopoly with a history of price co-ordination, and formidable impediments to entry".⁷⁰¹ In this respect, the FTC didn't hesitate to provide examples of MAP practices and market transparency. Similarly to the assessment of the proposed merger between Warner and PolyGram, the FTC took into account non-price matters, which are crucial in terms of the record industry; for example, entry conditions and expansion opportunities by independent labels (the discussion below will demonstrate how these non-price matters are arguably more important than price concerns).⁷⁰² The FTC was of the view that independents operate in a different market segment than the majors, due to the fact that the majority of independents do not have established artists and catalogues, neither do they own their own distribution companies, or possess any marketing mechanisms (such as the in-house PR available at the majors). Therefore, it was concluded that, were there to be an anti-competitive price increase by the majors, independents would have not been able to defeat it,⁷⁰³ and therefore could not provide strong enough competition to the majors. Going slightly ahead, it should be noted that the Commission in its second ruling on the Sony/BMG merger (see below) also similarly expressed the view that independents would not be able to defeat an anti-competitive price increase, and therefore would not be able to compete strongly with majors. This, in turn, points to a lack of effective competition in the recorded music market.

⁷⁰¹ Boast, *supra*, n. 697.

⁷⁰² It is not known, however, whether the FTC considered the cultural issues directly.

⁷⁰³ Boast, *supra*, n. 697.

5.3.2. Sony/BMG Merger

In order to understand the way the competition authorities dealt with recent mergers in the record industry, the Commission's decision on SonyBMG is analysed first, followed by the CFI prohibition judgment then the second approval of the merger by the Commission. The first two rulings are very interesting because they focus *only* on the economic analysis of the record industry, completely leaving out the in-depth analysis of non-price competition issues such as cultural and product diversity (this is submitted in the Conclusion). The non-price issues are discussed for the first time in the EU reasoning in the course of the third ruling, but as the analysis below will demonstrate, the Commission has only given 'surface treatment' to these issues.

5.3.2.A. The Commission's Sony/BMG Clearance Decision

“The Commission's ruling in Sony/BMG appears to be a bit of a Friday afternoon job.”⁷⁰⁴

This particular merger is important because it was the first big test case for the Commission's application of their new economic approach. This section provides a critical assessment of the Commission's grounds for allowing the two companies to merge. First, to assist the reader in understanding this complex case, the sequence of each ruling is provided in Table 2.

⁷⁰⁴ Quoting Mike Pullen, partner at DLA Piper. Also cited in Tobias Buck, “Watchdog Reels at Sony/BMG Ruling,” *The Financial Times*, July 13, 2006.

Table 2: The Sequence of Events of the Sony/BMG Merger

Sony/BMG Merger	
Date	Outcome
20 July 2004	Merger approved by the EU Commission (hereinafter, the decision).
13 July 2006	Merger disallowed. The independents' trade body, Impala, wins at the Court of First Instance against the Commission's Decision in 2004 (hereinafter, the annulment judgment).
03 October 2007	Merger re-approved by the Commission (hereinafter, the approval).
30 November / 20 December 2007	The European Parliament questions the Commission as to the approval of the SonyBMG for the second time, and its affect on cultural diversity and small business.
10 July 2008	The annulment judgment of the CFI was set aside by the European Court of Justice and sent back to the CFI for the re-assessment.
05 August 2008	Sony buys 50 percent of BMG's stake.
30 June 2009	The CFI held that any further action would be devoid of purpose and that there would be no more adjudication on the case of Sony/BMG.

Before going into the grounds for allowing Sony and BMG to merge their record businesses, a brief chronology is provided to illustrate how quickly the Commission can change its mind. In January 2004, Sony and Bertelsmann notified the Commission of

the proposed merger under the old ECMR.⁷⁰⁵ In February, the Commission started its investigation as it was concerned that the proposed merger might create or strengthen a collective dominant position of the major record companies (the old EC merger test). On 24 May 2004, the Commission issued a statement of objections to the parties in which it provisionally concluded that the transaction was *incompatible* with ‘common market’. However, at a hearing in July 2004, the Commission made a fundamental U-turn and granted *unconditional* approval to the merger. The main reason for the Commission’s approval was that there was insufficient evidence that the four major companies could tacitly coordinate their prices through a collective dominant position. As a result, in 2004 Sony and Bertelsmann merged their global recorded music businesses.

The merger was highly anticipated, however, the music industry insiders never believed it would be allowed.⁷⁰⁶ Sony/BMG was a five to four merger (four to three in Greece). The combined market shares of the majors ranged in the region of 70 to 90 percent depending on the country. Therefore, the main issue to discuss in this section is why this particular merger was allowed, whereas others that presented similar issues were blocked?

The first main difference between the Sony/BMG merger, which was allowed, and the other mergers that were disallowed, is that they Sony and Bertelsmann did *not* merge their music publishing activities, manufacturing and distribution chains. Sony and BMG only merged their Artist & Repertoire departments and were said to be involved in the subsequent marketing and sale of recorded music.⁷⁰⁷ The two companies alleged that those activities would not affect competition because the merger was aimed at concentrating on the developing of new artists and the selling of their records.

The Commission, in turn, identified three relevant *product* markets: recorded music, online music, and music publishing.⁷⁰⁸ As the then five major record companies dominated the global music market, the investigation focussed primarily on the marketing of recorded music.

⁷⁰⁵ As the joint venture was notified in January 2004, it was investigated under the old ECMR regulation.

⁷⁰⁶ Particularly after Warner/PolyGram and EMI/Warner’s attempts to merge in the past had been unsuccessful.

⁷⁰⁷ Case No COMP/M.3333 – *Sony/BMG*, supra, n. 315, at para 6.

⁷⁰⁸ *id.*, at paras 9 – 45.

5.3.2.A.i. Legal Critique of the Decision

The following discussion critiques the Commission's general approach towards the *application* of the *existing law* to merger cases. This section also lays the ground for further debate on the Commission's approach to mergers based on the existing ECMR, being largely dictated by economic considerations, as opposed to cultural diversity (see the Conclusion). The argument remains that cultural industries should not be assessed on a pure economic basis, and also that non-price issues should be taken into account. This point is integral to this thesis, and makes it unique.

In order to assess whether the proposed venture would create or strengthen a collective dominant position in the relevant product markets, the Commission referred to the following two economic parameters of the industry: (i) parallel wholesale pricing; and (ii) discounts. To examine the current competitive dynamics in the record industry, the Commission carried out a price survey spanning the four years prior the merger. It focused on the average net prices on a quarterly basis for the top 100 albums of each major in the five largest Member States of the EU and it also examined whether the parties could have achieved any price co-ordination on the basis of parallelism in average prices. Despite the fact that there was a certain degree of parallelism in the markets studied, the Commission thought the evidence was not sufficient enough to establish co-ordinated pricing behaviour.⁷⁰⁹ Having said that, the 'published prices per dealer'⁷¹⁰ (hereinafter, PPD) were readily published in catalogues and were therefore transparent to the competitors, which in turn pointed to the possibility of price monitoring⁷¹¹ and price co-ordination by the majors.⁷¹² In order to see whether or not there was any price co-ordination, the Commission analysed whether majors' discounts were aligned and sufficiently transparent so as to allow efficient monitoring of price co-ordination as well as on the level of net prices.⁷¹³ However, the analysis of discounts made the Commission come to the conclusion that it could not establish price co-ordination because the discounts were found to vary from album to album.⁷¹⁴ Therefore, even though the Commission demonstrated that there was a certain degree of

⁷⁰⁹ *id.*, at paras 75, 82, 89, 96, 103.

⁷¹⁰ See the glossary for the definition.

⁷¹¹ Case No COMP/M.3333 – *Sony/BMG*, *supra*, n. 315, at para, 76.

⁷¹² *id.*, at paras 77, 84, 91, 98 and 105.

⁷¹³ *id.*, at para 74.

⁷¹⁴ *id.*, at paras 79-80, 85-87, 92-94, 99 – 101 and 106 – 108.

price co-ordination, it could not prove the existence of collective dominance in any of the five largest Member States.⁷¹⁵

Since the Commission analysis showed *some* indications of co-ordinated behaviour, it then had to further analyse whether the markets for recorded music were characterised by features facilitating collective dominance. The features chosen were product homogeneity,⁷¹⁶ transparency,⁷¹⁷ and retaliatory measures.⁷¹⁸

1) Product Homogeneity

Regarding product homogeneity, the Commission noted that heterogeneity in the *content* reduced transparency in the market and made tacit collusion more difficult.⁷¹⁹ It seems that in this analysis, the Commission relied on the opinion of the parties themselves (Sony and BMG) that recorded music released by majors constituted a *heterogeneous* product, as each release was unique. This opinion is, of course, highly debatable but the Commission did not seem to wish to investigate that discussion any further. From the competition theory point of view, homogenous products may play a crucial role in collusive behaviour “because it is easier to monitor the prices and output of a single commodity product than to keep track of competitor behaviour in relation to hundreds of distinct items”.⁷²⁰ Despite the above, the Commission (and the CFI, as discussed below) ignored the issue of cultural diversity. It is not clear why the Commission blindly took on board both Sony and BMG’s statements that their products were heterogeneous and why it neglected the issues of format homogeneity, particularly when the Commission itself stated that the CD format, its pricing, and the marketing strategies employed were ‘quite standardised’.⁷²¹

2) Transparency of the Recorded Music Market

Since there was enough evidence of steady long-term relationships between majors and distributors, the Commission considered whether the market for recorded music was

⁷¹⁵ *id.*, at para 109.

⁷¹⁶ *id.*, at para 110.

⁷¹⁷ *id.*, at paras 111-3.

⁷¹⁸ *id.*, at paras 114-118.

⁷¹⁹ *id.*, at para 110.

⁷²⁰ John Boyce and Deborah Cresswell, “How Many Competitors is Enough?”. *Global Legal Group*. (2005): 11.

⁷²¹ Case No COMP/M.3333 – *Sony/BMG*, *supra*, n. 315, at para 110

transparent enough to constitute a state of collective dominance. The weekly charts, together with sales data and the fairly publicly known PPDs, pointed to *high transparency* within the recorded music market. However, it was noted that even though there were only very few retailers, which sold the albums released by the majors, the fact that some of them had different list⁷²² prices would make it more difficult to monitor a tacit agreement. Despite that, the Commission contradicted itself by pointing out that the situation was “conducive to the adoption of co-operative strategies on behalf of the majors and also facilitated the monitoring and the information flow”,⁷²³ for example the weekly hit charts.

3) Retaliatory Measures

In its final attempt to establish the existence of a collective dominant position amongst the majors, the Commission explored whether or not there were any indications that the majors had retaliated against any ‘cheating’ major in the past, particularly in respect to hit compilation albums.⁷²⁴ Sony and BMG, akin to Time Warner and EMI, participated in numerous compilation deals with other majors. Compilation albums accounted for 15 - 20 percent of the recorded music market,⁷²⁵ and as such excluding a ‘defector’ from future compilation deals or refusing to license an artists’ music for the defector’s compilations, could constitute an effective retaliation mechanism. Nevertheless, the Commission ignored the evidence, ruling that because there was no deterrent mechanism ever employed there was neither tacit collusion nor collective dominance in the recorded music market.

The above analysis prompted the Commission to conclude that:

“There was not sufficient evidence to prove that the reduction of the majors from five to four represents a change substantial enough to result in the likely creation of collective dominance. In particular, the Commission has not found sufficient evidence that a reduction from five to four majors would facilitate transparency and retaliation to such extent that the creation of a collective dominant position of the remaining four majors has to be anticipated”.⁷²⁶

⁷²² See the glossary for the definition.

⁷²³ Case No COMP/M.3333 – *Sony/BMG*, supra, n. 315, at para 112.

⁷²⁴ *id.*, at paras 114 - 118.

⁷²⁵ *id.*, at para 115.

⁷²⁶ *id.*, at paras 154 - 157.

In ruling out pre-merger collective dominance, the Commission also ruled out the creation of post-merger collective dominance based on the same three characteristics of product heterogeneity, market transparency, and retaliatory mechanisms.⁷²⁷

As a final point, the Commission considered spill-over effects from the proposed merged entity on the activities of Sony and BMG in the distribution of online music and music publishing.⁷²⁸ The first spill-over being the creation of a dominant position in the national markets for distribution of online music due to the vertical relationship between Sony and Sony Connect.⁷²⁹ Sony Connect could have provided SonyBMG with even more power, and for example, could have denied their competitors access to its back catalogue,⁷³⁰ or they could have chosen to promote their artists instead of their competitors' artists. The denial of access by digital operators to the SonyBMG's back catalogue seems to be an important issue to the Commission as it highlighted the same point in the second ruling too (discussed below in relation to the second approval of SonyBMG). This shows how attention is given to making sure that there is good access to *the same* content, but not, it seems, to preventing content homogeneity.⁷³¹ The Commission found that the access *was* denied in the past but nevertheless it ruled out the creation of single dominance because in 2004 there were other players in the market, for example OD2. The second concern about the spill-over effect was raised by the third parties⁷³² in relation to the Bertelsmann music publishing interests.⁷³³ Even though the parties did not merge their publishing departments, the parties could have co-ordinated their behaviour in music publishing.⁷³⁴ However, as the administration of publishing rights was predominantly in the hands of the collecting societies,⁷³⁵ this claim was put aside too. Thus, the merger was allowed.

⁷²⁷ *id.*, at paras 155 – 158.

⁷²⁸ *id.*, at paras 176 – 182.

⁷²⁹ *id.*, at paras 171 – 175.

⁷³⁰ *id.*, at para 171.

⁷³¹ Evangelia Psychigiopoulou, "EC Competition Law and Cultural Diversity: The Case of the Cinema, Music and Book Publishing Industries." *European Law Review* 30, no. 6 (2005): 848.

⁷³² Third parties included Apple Computer, Universal Music International, European Consumers' Organisation, Impala, International Music Managers Forum, EMI, Warner and Time Warner.

⁷³³ Case No COMP/M.3333 – *Sony/BMG*, *supra*, n. 315, at para 177.

⁷³⁴ *id.*, at para 178.

⁷³⁵ *id.*, at para 179.

5.3.2.A.ii. Sony/BMG Decision: The Main Conclusions

The approval of the merger triggered a critique not just from the independents' trade bodies but the Advisory Committee of the Commission as well. The latter reported a minority dissent on the approval of the merger.⁷³⁶ Hence, the next step is to look into the 'outside' reasons for why the merger was approved as well as some contradictions present in the decision.

There are a number of factors that influenced both the EU and US decisions *not* to prohibit the merger. Firstly, when the merger was being considered, the majors were only marginally successful at selling their music content on-line, owing, in no small part, to the greater internet-based piracy of music content that was prevalent at that time. Secondly, prior to the Sony/BMG merger, the Commission had faced three defeats in front of the CFI since 2002; these defeats have been cited as another reason for the merger's approval.⁷³⁷ Thirdly, because Sony/BMG was structured as a joint venture and was announced prior to recent amendments to the Hart-Scott-Rodino Antitrust Improvements Act of 1976 in the USA, the parties were not required to notify the transaction to US antitrust enforcement agencies.⁷³⁸ However, the most plausible reason for the approval of the merger by the Commission seems to be a higher burden of proof set by the *Airtours*. The tripartite test for collective dominant position established in the *Airtours* case is very difficult to satisfy and it left the Commission with less freedom to block a merger, except where collective dominance could be proved or where a merger would lead to a single dominance, usually meaning a market share of 40 percent. That explains why some refer to collective dominance test as a legal 'straitjacket', which focuses on static considerations whilst ignoring wider dynamic and behavioural factors.⁷³⁹

⁷³⁶ Opinion of the Advisory Committee on Concentrations Concerning a Preliminary Draft Decision in case COMP/M.3333 - Sony/BMG. Brussels, July 9, 2004.

⁷³⁷ Kenneth Logan *et al.*, "Antitrust Developments in the Media and Entertainment Industries," *Simpson, Thatcher and Bartlett*, September 22, 2004.

⁷³⁸ *Federal Trade Commission*, "FTC Closes Investigation of Joint Venture between Bertelsmann AG and Sony Corporation of America," July 28, 2004; Fabio Polverino, "Assessment of Co-ordinated Effects in Merger Control: Between Presumption and Analysis," *Social Science Research Network* (2006): 35-36.

⁷³⁹ This is the view of some economists. See Mario Monti, "The Substantive Standard for Merger Control, and the Treatment of Efficiencies in Merger Analysis: An EU Perspective," Fordham Annual Antitrust Conference, New York, October, 30-31, 2002, at p. 2.

According to the judgment in *Airtours*, it is up to the Commission to prove that the entry barriers for smaller companies are very high. That, in itself, makes it extremely difficult to demonstrate the existence of collective dominance. The burden of proof is so high that even one of the Commissioners noted that: "...the evidence available [in Sony/BMG] was not sufficiently strong to prove collective dominance".⁷⁴⁰ At the same time, it was stated that: "the high degree of concentration in the music industry remains a concern and the Commission will continue to closely monitor the development of the music markets".⁷⁴¹ These contradictory statements signal the situation that the Commission had to clear the mergers with *unclear* evidence; the Sony/BMG merger is a prime illustration of the dilemma the Commission faced. The merger case demonstrated that it is virtually impossible to provide concrete evidence in order to prove the three factors; and even in a best case scenario the evidence provided will not be unequivocal. This leads to the question of what should happen if neither anti-competitive effects, nor their absence could be proved in a precise way?⁷⁴² The record industry provides a perfect example of how often such a situation may arise. In such ambiguous cases, it has been suggested that every piece of evidence should be evaluated in the context of '*the whole set of the evidence available*',⁷⁴³ i.e. the evidence needs to be considered as a whole. In this context, Judge Richard Posner noted in the *High Fructose Corn Syrup* case decision:

"The second *trap to be avoided* in evaluating evidence of an antitrust conspiracy ... is to suppose that *if no single item of evidence presented by the plaintiff points unequivocally to conspiracy, the evidence as a whole cannot defeat summary judgment*. It is true that zero plus zero equals zero. But evidence can be susceptible of different interpretations, only one of which supports the party sponsoring it, without being wholly devoid of probative value for that party. Otherwise, what need would there ever be for a trial? The question for the jury in a case such as this would simply be whether, when *the evidence was considered as a whole, it was more likely that the defendants had conspired to fix prices than that they had not conspired to fix prices*" (emphasis added).⁷⁴⁴

And,

"...no single piece of the evidence ... is sufficient in itself to prove a price-fixing conspiracy. But that is not the question. The question is simply whether this evidence,

⁷⁴⁰ Peter Eberl, "Following an In-depth Investigation the Commission Approved the Creation of the Sony/BMG Music Recording Joint Venture on 19 July 2004." *Competition Policy Newsletter* 3 (2004): 10.

⁷⁴¹ *id.*

⁷⁴² Gisela Aigner *et al.*, "The Analysis of Coordinated Effects in EU Merger Control: Where Do We Stand after Sony/BMG and Impala?" *Social Science Research Network* (2006): 20.

⁷⁴³ Polverino, *supra*, n. 738, at p. 38.

⁷⁴⁴ *In re High Fructose Corn Syrup Antitrust Litigation* 295 F.3d 651 US Court of Appeal (7th Cir. 2002), 665-56.

considered as a whole and in combination with the economic evidence, is sufficient to defeat summary judgment.⁷⁴⁵

These statements could help support the argument that there should be a broad assessment of the complicated mergers with unclear evidence, as opposed to a pure economic analysis.

Whilst assessing the possible effects of the Sony/BMG merger on the independents, the Commission looked at typical competition law issues, such as market shares and price. The overall market share in the recorded music business did not change after the merger. However, it would be incorrect to consider the merger only as the mathematical adding up of the two companies' market shares. A combined market share equals combined market power, which allows greater ability and power to dictate market conditions, or to lower output and reduce the quality of content, and diversity. Here the Commission followed the guidelines set up in *Airtours*, which emphasised the importance of the economic analysis of a merger. However, what the Commission should have concentrated on is not the amount of the economic analyses and methodologies applied but rather the *quality*, and *relevance* of the economic data. For example, the Commission paid huge attention to *price* matters, as it would indeed in any other merger. However, as is debated more rigorously below and in the following chapter, there exists the argument that, given that the record industry is a cultural industry, it should, therefore, be assessed on *non-price* competition issues as well as the price issues,⁷⁴⁶ including, for example, genre and artist diversity, radio and TV access, artist acquisition and development. Clearly, there are more important issues in the record industry these days than just price increases, which, as discussed above, are not on the agenda in any case since the products were already overpriced in 2004. The Commission simply ignored other crucially important issues, such as physical and online distribution, combined financial, licensing and lobbying powers of the new venture as well as the doubled advertising and marketing budgets that would result.

The Commission itself noted that the way in which albums were priced and marketed at the wholesale level appeared to be standardised.⁷⁴⁷ Hence, it is not clear why the Commission disregarded the relationship between the record companies (sellers) and

⁷⁴⁵ *id.*, at p. 661.

⁷⁴⁶ Black and Greer, *supra*, n. 112, at p. 13.

⁷⁴⁷ Case No COMP/M.3333 – *Sony/BMG*, *supra*, n. 315, at para 110.

wholesale distributors (their customers) in its assessment of price-related issues in the record industry. In George Stigler's seminal work, *A Theory of Oligopoly*, the definition of 'homogeneity' included homogeneity both in product (*sellers*) and in purchase commitments (*buyers*).⁷⁴⁸ Accordingly, if the price of the product is determined in a standardised way,⁷⁴⁹ transactions would be regarded as uniform, the product deemed homogenous, irrespective of that products' content.⁷⁵⁰ Thus, the uniform pricing of CD's could be seen as helping sustain collusive behavior.⁷⁵¹ In this respect, the Long Tail could be argued to provide a counterweight, but it is not clear whether it could at this stage defeat the price structures for the physical products.

Unlike in *Airtours*, the Commission in its decision of Sony/BMG did not give proper attention to the merger's potential effect on independents. In *Airtours*, the Commission devoted a large part of the judgment to a thorough analysis of the challenges, which the small travel operators were facing. These 'challenges' included the marginalisation of competitive force,⁷⁵² lack of vertical integration,⁷⁵³ disadvantaged sale of seats,⁷⁵⁴ distribution of package holidays⁷⁵⁵ and cost disadvantages of small tour operators.⁷⁵⁶ It was also held that the elimination of First Choice as a middle-sized competitor was significant because it would create a wider gap between the large and small players.⁷⁵⁷ By contrast, in the assessment of the Sony/BMG merger there was no real emphasis on the independents except looking at their differences in terms of distribution, organisational structure, and marketing power. Providing a list of different characteristics of majors and independents can hardly be considered sufficient in order to fully appreciate the effect of the merger on the independents, and it shows a lack of foresight or reluctance on the part of the Commission, to wish to understand the challenges faced by small businesses in the recorded music market and the relevance of this to the issue at hand. However, the Commission did admit that independents were experiencing serious barriers to expansion: "for (international) distribution the

⁷⁴⁸ George J. Stigler, "A Theory of Oligopoly." *The Journal of Political Economy* 72, no. 1. (1964): 44.

⁷⁴⁹ Record industry is not the only industry where heterogeneous products have mainly uniform prices, for example, the movie-theatre industry and the supermarkets. See Barak Orback and Liran Einav, "Uniform Prices for Differentiated Goods: The Case of the Movie-Theatre Industry." *Social Science Research Network* (2006).

⁷⁵⁰ Polverino, *supra*, n. 738, at p. 29.

⁷⁵¹ *id.*

⁷⁵² Case No IV/M.1524 - *Airtours/First Choice*, *supra*, n. 648, at para 84.

⁷⁵³ *id.*, at para 78.

⁷⁵⁴ *id.*, at para 79.

⁷⁵⁵ *id.*, at para 81.

⁷⁵⁶ *id.*, at para 83.

⁷⁵⁷ *id.*, at para 73.

independents often depend on the distribution networks of the majors. Even those independent record companies, which have their own distribution facilities on a national basis, rely on the majors' or other independents' international distribution facilities".⁷⁵⁸ Unfortunately, it did not elaborate on these concerns. *None* of the problems relating to the practical aspects of radio play, advertising time, A&R, shelf space, manufacturing, promotion, and licensing were even touched upon, even though these are crucial parameters for the record industry, and are arguably more important than price co-ordination and transparency in the market (see more on the importance of non-price issues in Section 5.3.2.C.ii. and Conclusion).

Having examined the Sony/BMG and Warner/PolyGram decisions, a number of crucial differences can be identified. Firstly, the tests themselves, collective dominance and SLC, are *similar* in that they are both economic-based tests but at the same time, they are *dissimilar* in their application. The Warner/PolyGram merger illustrates that the SLC test is less legally rigid than the dominant position test.⁷⁵⁹ Therefore, it gives the FTC more room for manoeuvre. Secondly, the factors which the US court took into account in Warner/PolyGram are totally different from the ones considered in the Sony/BMG case: the US Court of Appeals considered the level of concentration in the music market, the tendency for increasing it and entry barriers. The Commission as regards Sony/BMG seems to have shut its eyes to those factors. Had the Court of Appeals' reasoning and the SLC test been applied to the Sony/BMG merger request, it is unlikely to have been allowed.

Nevertheless, the approval of the Sony/BMG merger demonstrates once again the point of legal uncertainty in relation to mergers in the record industry; it was surprising that the FTC in the USA also approved the Sony/BMG merger without a more thorough investigation. However, in a statement by Commissioner Thompson about the investigation closure into the Sony/BMG merger by the FTC, he noted:

"...my decision was a difficult one, in part because I am particularly concerned about the impact of media mergers on the prices and quantity of media, as well as the *diversity of content*, available to consumers. The industry is highly concentrated among record labels, and the proposed joint venture will only enhance this concentration. Additionally, the history of parallel Minimum Advertised Price policies in particular

⁷⁵⁸ Case No COMP/M.3333 – *Sony/BMG*, *supra*, n. 315, at para 54.

⁷⁵⁹ See *European Competition Commission*, "Green Paper on the Review of Council Regulation no. 4064/89." 11 December 2001, at para 165.

indicates a propensity for independent behaviour among the major labels” (emphasis added).⁷⁶⁰

The Commission too noted that there was a *conduciveness* to collective dominance⁷⁶¹ but there was not enough evidence to establish a collective dominant position. That is a pivotal statement. Unfortunately, the Commission did not elaborate on it. Moreover, no conditions have been imposed on the merged company, which means that in future they could radically change their behaviour and not be penalised for that. By contrast, in *Airtours*, it was ruled that sufficient deterrents should exist to ensure that tacit collusion would not be sustainable.

5.3.2.B. The CFI’s Prohibition Judgment

This section analyses the CFI’s heavy criticism of the Commission’s approach to the application of the existing law, but it additionally demonstrates that the CFI too used the economic-based approach in annulling the Commission’s decision. These two rulings open up the debate in the thesis’ final chapter for the need to take the diversity of cultural products and producers into account when considering mergers in the cultural sector.

On 13 July 2006, the European Court of First Instance unexpectedly annulled the Sony/BMG merger.⁷⁶² The judgment came after Impala appealed to the CFI against the merger. Impala is a European trade body for independents, set up by the Association of Independent Music, which to date represents about 3,000 independent labels. ‘Shock’, ‘surprise’, and ‘unexpected blow’ are just some of the words used to describe the reaction to the CFI’s ruling.⁷⁶³ Independent music labels were euphoric, whilst majors were at a loss.

⁷⁶⁰ Statement of Commissioner Mozelle W. Thompson, “Sony Corporation of America/Bertelsmann Music Group Joint Venture, File No. 041-0054.” *Federal Trade Commission*, July 28, 2004.

⁷⁶¹ Case No COMP/M.3333 – *Sony/BMG*, supra, n. 315, at para 157.

⁷⁶² Case T464/04 - *Impala v. Commission* [2006] ECR II-2289, supra, n. 459.

⁷⁶³ See *European Competition Commission*, “The Court of First Instance Annuls the Decision Authorising the Creation of SonyBMG.” July 13, 2006; Paul Betts, “Court Edict Puts Record Industry in a Spin,” *The Financial Times*, July 13, 2006.

Before going into the discussion of the judgment in greater detail, some background and a summary of the parties' arguments are first provided for a better understanding of the CFI's ruling.

a) Impala's Arguments

Initially, Impala publicly criticised the Commission's decision because of the disregard of the foreclosure of the independents from retail and radio stations, resulting in the diminished choice and *diversity* in terms of new genres and artists:

“Diversity is not a philosophy. It is a necessity. The Sony/BMG decision goes against the Commission's own assessment of the market, not only in Sony/BMG but also in 2000 in the attempted EMI/Warner merger. The EU is legally obliged to ensure the defense of cultural diversity across all policy areas. The decision to authorise the merger is a legal, economic, political and cultural mistake. This is a sentiment Jan Figel, the new EU Commissioner for Culture, clearly underscored when he reminded the European Parliament that European integration is more than just an economic or geographical challenge, it is also a question of values, civilisation and cultural heritage”.⁷⁶⁴

Perhaps recognising the difficulty in succeeding on diversity as a *legal* argument, in front of the CFI, Impala decided to put the cultural diversity argument aside, which would seem advisable, given that the old merger test did not provide for a cultural argument. Instead Impala chose to present five legally grounded arguments, two of which were that the Commission (i) infringed Article 253 EC and (ii) wrongly asserted that there was no collective dominant position⁷⁶⁵ on the market for recorded music prior to the proposed merger. The Court concentrated only on those two pleas (the fact that the CFI chose to concentrate only on two pleas out of five later led to the annulment of this judgment by the ECJ in 2008).⁷⁶⁶

Impala's claim was based on the following arguments:

- The record industry was highly conducive and co-ordination did take place;
- The record industry had a stable customer base;
- Sony and BMG were monitoring the retail market on a weekly basis;

⁷⁶⁴ Quoting Patrick Zelnik, President of Impala. See *Impala*, “European Independents Appeal Sony/BMG Merger.” November 3, 2004.

⁷⁶⁵ Case No COMP/M.3333 – *Sony/BMG*, *supra*, n. 315, at para 53, 56, 148, 110, 112 and 113.

⁷⁶⁶ For more on the annulment by the ECJ see the Conclusion.

- The majors had a high market share;
- The majors had significant financial strength;
- High prices of the products and homogeneity of product in its format (not the content);
- Parallelism of the net prices as well as the public knowledge of public selling prices;
- Oligopolistic structure of the record industry;
- The Commission relied on the information provided by Sony and BMG on discounts rather than on the information on the parallelism between PPDs and the net prices for all of the majors;
- A high level of transfer of senior executives between the record companies;
- Sony and BMG produced weekly reports monitoring the retail market, which included information on their competitors; and,
- Weekly charts and retail prices made it very easy to detect how much a major is charging for hit albums. That is because majors only needed to monitor a limited number of best-selling albums to account for most sales.

Impala contended that these factors meant that, even if it was not possible to predict the price of each individual release charged to each individual retailer at every point in time, it would still be possible to know net prices and that this in turn provided the transparency necessary to establish the existence of collective dominance.

Impala also claimed that in order to establish whether or not a concentration would strengthen a collective dominant position, the Commission must carry out a *prospective* analysis, and not a *retrospective* analysis, as was done in the Sony/BMG decision.

b) The Commission's Arguments

The Commission objected to Impala's claims by stating that there was indeed a degree of stability in the customer base and that certain monitoring took place but it did not find that such monitoring was sufficient to overcome the lack of transparency of discounts, in particular campaign discounts. It argued that the majors could co-ordinate their prices but only if they monitored 400 albums of their competitors. The Commission stressed that it would require not just increased monitoring but also efforts to identify discounting practices, which would be very resource-intensive for any major.

c) Sony/BMG's Arguments

In the words of the interveners, Sony and BMG, the merger represented a pro-competitive response to the decline (a 20 percent fall in CD prices in three years, increased illegal downloading of music and increased competition from alternative products such as films on DVD) and continuing change in the music industry. They omitted to mention other contributing factors, such as the general economic downturn, the still high cost of CDs to the consumer,⁷⁶⁷ as well as a broader failure to meet consumers' tastes and an absence of quality content and innovative music.

5.3.2.B.i. Findings of the Court of First Instance

1) Critique of the Decision

Before going into the collective dominance test it should be stated that the CFI criticised the Commission's 'extremely succinct'⁷⁶⁸ analysis as "superficial, indeed purely formal, particularly in the case of a concentration that raises serious problems".⁷⁶⁹

Since the Sony/BMG case was considered under the old ECMR,⁷⁷⁰ the CFI also applied the old merger test. Collective dominance formed the core of the judgment. It also reinforced the three conditions set out in *Airtours*⁷⁷¹ in order for collective dominance to be established, and upheld Impala's claim, in that the Commission was obliged to assess, using a *prospective* analysis, whether or not the concentration would lead to a situation in which effective competition in the relevant market would be significantly impeded. The CFI also emphasised the importance of the *Airtours* test adding that the Commission must provide '*solid evidence*'⁷⁷² in its decisions.

On the whole, the CFI heavily criticised and admonished the Commission. As stated earlier, in order to analyse whether the majors had pursued a co-ordinated price policy, the Commission first looked into the average net prices of each major in the five largest

⁷⁶⁷ Interestingly, in the original decision, the Commission made it clear that the decline in the demand for CDs was due, among other things, to the fact that the CDs were overpriced. Case No COMP/M.3333 – *Sony/BMG*, supra, n. 315, at paras 56-9.

⁷⁶⁸ Case T464/04 - *Impala v. Commission*, supra, n. 459, at para 525.

⁷⁶⁹ *id.*, at para 528.

⁷⁷⁰ Council Regulation (EEC) No 4064/89, supra, n. 651.

⁷⁷¹ *Airtours v Commission* (2002), supra, n. 652.

⁷⁷² Case T464/04 - *Impala v. Commission*, supra, n. 459, at para 248.

Member States from 2000 - 2004.⁷⁷³ The Commission also examined whether the different majors' discounts were aligned and transparent. The CFI concluded that in doing so, the Commission paid too much attention to *campaign* discounts without even assessing their relevance and giving any explanation as to why they were chosen in preference to file discounts.⁷⁷⁴ However, in the decision the Commission asserted: "...in all countries, the most important discounts are *file* discounts".⁷⁷⁵ Nor was there any definition of what campaign, file, and invoice discounts were. Placing too much weight on discounts, and in particular campaign discounts was held to be incorrect, thus upholding another one of Impala's claims. The CFI also demonstrated that the Commission was selective in the data it relied on, as well as the extent to which the merging parties managed to persuade the Commission in their own interpretation of their data, e.g. the heterogeneity of content. Indeed, how could the Commission come to the conclusion as to the heterogeneous nature of the musical content when in paragraph 58 of its decision it stated that "part of the decline of the records' sales could be explained by the record companies' failure to meet the consumers' tastes, the absence of quality content and of innovative artists" (see more on this in the Conclusion). In the view of the CFI, the Commission did not even attempt to challenge or to check the submission by the parties as to the heterogeneous nature of their content.

2) Transparency of the Recorded Music Market

Transparency constituted the crucial part of the CFI's criticism of the decision. For example, in the Statement of Objections, the Commission set out that the proposed merger was *incompatible* with the common market because of the existing collective dominant position. It also stated that the market for recorded music was *transparent* and particularly *conducive to co-ordination*. Throughout the investigation lasting five months, the Commission's view did not change. Such a U-turn in the eventual decision surprised the CFI.⁷⁷⁶ It was only in the wake of the arguments presenting at hearings on 15th and 16th June 2004 that, without carrying out any fresh market investigations, it adopted the opposite position and allowed the parties to go ahead with the merger.

⁷⁷³ Case No COMP/M.3333 – *Sony/BMG*, supra, n. 315, at para 69.

⁷⁷⁴ See the glossary for the definition of 'campaign, file and invoice discounts'.

⁷⁷⁵ Case No COMP/M.3333 – *Sony/BMG*, supra, n. 315, at para 150. In paragraph 78, the Commission stated that "invoice discounts are ... by far the most important discounts".

⁷⁷⁶ The CFI stated that Commission had to justify the reasons for such a U-turn between the Statement of Objections and the final decision. However, in an earlier case, T-210/01 – *General Electric v. Commission*, 14 December 2005 (unreported), at para 513, the CFI stated that Commission was under no obligation to explain U-turns from previous decisions from the same market.

The section on transparency in the original decision contained only three paragraphs, although according to the position defended by the Commission in its written submissions to the Court “in the present case transparency is the *essential*, and indeed *the only*, ground for the assertion that there is no collective dominant position in the market for recorded music”.⁷⁷⁷ It was not even concluded that the market was not transparent, or even that it was not sufficiently transparent to allow tacit collusion. At the very most, the Commission stated that the monitoring of campaign discounts at album level “... could reduce transparency in the market and may make tacit collusion more difficult”.⁷⁷⁸ Arguably, such a vague assertion could not support the finding that the market was not sufficiently transparent to allow a collective dominant position, and details were lacking as regards the nature and operation of campaign discounts, their degree of opacity, their size and impact on price transparency. Another inconsistency included the Commission itself noting that examining the way discounts were aligned was not a completely valid test to measure market transparency and saying that “even the alignment of discounts cannot demonstrate such transparency”.⁷⁷⁹

Moreover, it was held by the Commission that the public nature of gross prices and the limited number of albums to be monitored were all capable of giving rise to a high level of transparency of prices. The Commission went further to state that: “there are further devices in the market which increase *transparency* and could facilitate the monitoring of an agreement”,⁷⁸⁰ for example, hit charts and established relationships between retailers and majors. It also acknowledged that Sony and BMG had set up a system of weekly reports, which included information on competitors. It is these inaccuracies and inconsistencies that beg the question as to how the Commission reached their initial decision in the first place.

In its assessment of the competitive dynamics in the recorded music market the Commission drew evidence from various countries and perhaps the example of how the questionnaires have been dealt with in Italy illustrates best how poor the Commission’s assessment was. In the words of the CFI: “it is scarcely possible to understand how the Commission was able to consider that ‘a majority’ of the customers’ responses revealed that the majors had only ‘*some knowledge*’ of their competitors’ discounts, when

⁷⁷⁷ Case T464/04 - *Impala v. Commission*, supra, n. 459, at para 289.

⁷⁷⁸ Case No COMP/M.3333 – *Sony/BMG*, supra, n. 315, at para 111.

⁷⁷⁹ Case T464/04 - *Impala v. Commission*, supra, n. 459, at para 306.

⁷⁸⁰ Case No COMP/M.3333 – *Sony/BMG*, supra, n. 315, at para 112.

footnote 55 to the decision states that ‘five out of five of the Italian retailers which replied to the question said that *majors are aware* of each other’s PPDs and discounts”.⁷⁸¹ Likewise, in the questionnaire used in France, footnote 49 states that “three out of four retailers said that majors were aware of each other’s PPDs and discounts”.⁷⁸² In the view of the CFI: “all factors...far from demonstrating the opacity of the market, show on the contrary, that the market *was* transparent”.⁷⁸³

It seems that the Commission made a valid point in front of the CFI in that price alignments, even of a considerable degree, may be quite common in the competitive structure of the market and thus do not necessarily constitute co-ordinated behaviour.⁷⁸⁴ However, the Court set out:

“... close alignment of prices over a long period, especially if they are above a competitive level, together with other factors typical of a collective dominant position, might, in the absence of an alternative reasonable explanation, suffice to demonstrate the existence of a collective dominant position, even where there is no firm direct evidence of strong market transparency, as such transparency may be presumed in such circumstances”.⁷⁸⁵

Overall, the CFI gave the impression that the empirical evidence, which the Commission had at its disposal, was sufficient to establish past co-ordinated behaviour.⁷⁸⁶ This falling out between the Commission and the CFI over the importance of price alignments once again exemplifies how uncertain legal regulation is, particularly when there is no concrete evidence.

3) Retaliatory Measures

The CFI also pointed out that the Commission made a mistake in relying on the absence of evidence regarding retaliatory measures having been *used* in the past, whereas according to the case law, *the mere existence* of effective deterrent mechanisms is sufficient, since when the companies comply with the common policy there is no need to have recourse to sanctions.⁷⁸⁷ There was a real possibility of sanctioning a ‘deviating’ major, as explained earlier, through excluding it from compilations and that

⁷⁸¹ Case T464/04 - *Impala v. Commission*, supra, n. 459, at para 375.

⁷⁸² *id.*

⁷⁸³ *id.*, at para 290.

⁷⁸⁴ Case T464/04 - *Impala v. Commission*, supra, n. 459, at paras 196, 210.

⁷⁸⁵ *id.*, at para 252.

⁷⁸⁶ *id.*, at paras 307, 311 and 320.

⁷⁸⁷ *id.*, at para 466.

fact alone would have been sufficient in order to establish an effective deterrent mechanism.⁷⁸⁸ Interestingly, one of the reasons why the TimeWarner/EMI merger was withdrawn was that the Commission had highlighted the possibility of retaliatory measures in the recorded music market, such as exclusion from the compilations. In 2004 however, the Commission was unable to indicate ‘the slightest step’ it may have taken to assess if retaliation had occurred in the past.⁷⁸⁹ Since the CFI did not require the Commission to show instances of actual punishment of deviators in the past, it clearly lowered the threshold in proving collective dominance in this respect. As indicated earlier, the collective dominance test in *Airtours* is very difficult to satisfy, particularly if the evidence is ambiguous; therefore, some lowering of the threshold seems to be a move in the right direction.

As both the transparency issue and retaliatory measures constituted the essential grounds on which the Commission concluded that there was no collective dominant position, the CFI found that each of those errors would in itself constitute sufficient reason to annul the decision.

4) Manifest Error of Assessment

For the purpose of making a thorough judgment, the CFI also considered another of Impala’s claims, i.e. the manifest error of assessment. As mentioned above, the Commission surprised the CFI at the U-turn between the Statement of Objections and the final ruling. The CFI observed that even though the Statement of Objections was a preparatory document, it did not mean that the document was without merit or wholly irrelevant. It stressed that the Commission should have at least explained its reasons for such a U-turn in the decision before the Court.

The Commission was also reprimanded for having relied on the data presented by the parties’ economists based on *their* chosen methodology. Moreover, the data prepared by those economic advisers to Sony and BMG was said to be *unclear* and *unreliable*. The CFI went on to discover even more contradictions in the decision. This section provides just a few of them. The Commission stated that a large number of albums priced at different list prices could complicate the monitoring of a tacit agreement.

⁷⁸⁸ id., at paras 463-474.

⁷⁸⁹ id., at para 471.

However, it noted at a later stage that majors only needed to monitor the prices of a limited number of best selling albums to account for most of the sales: “data provided by Sony and BMG show that the top 20 titles each year account for at least the yearly sales for BMG in all countries except Germany”.⁷⁹⁰

Even more faults were found in the questionnaires sent out to retailers during the Commission’s investigation. For example, the questionnaire asked the following question: “according to the experience of your purchasing department, are record companies aware of their competitors’ PPDs *and* discounts?” Only a tiny number of UK respondents gave the full answer, such as PPDs – yes, Discounts – no. Most of the respondents replied simply: *of course, absolutely, certainly*, thus blurring the issue as to whether these responses were referring to PPDs *or* discounts.⁷⁹¹ In the light of all those contradictions, it is not surprising that the CFI concluded that the evidence in the decision did not support the conclusions drawn from it,⁷⁹² thus establishing that the case was vitiated by a manifest error of assessment.

5.3.2.B.ii. Impala Judgment: The Main Conclusions

The Sony/BMG decision is the latest in a long line of overturned rulings. It is extremely rare, however, for the CFI to overturn approved mergers.⁷⁹³ Normally, the CFI overturns prohibition decisions.⁷⁹⁴ Apart from creating even more legal uncertainty, this particular judgment is very interesting for the following reasons:

1. An already joined company was facing a de-merger forced by law.
2. The differences in approaches between EU and US merger tests.
3. The grounds on which the CFI based its judgment.
4. The effect this ruling will have on the record industry.

⁷⁹⁰ Case No COMP/M.3333 – *Sony/BMG*, supra, n. 315, at para 111.

⁷⁹¹ Case T464/04 - *Impala v. Commission*, supra, n. 459 at para 383.

⁷⁹² *id.*, at para 377.

⁷⁹³ Case T-156/98 *RJB Mining v. Commission* [2001] ECR II-337, and partially annulled clearances in joined cases C-68/94 and C-30/95, *France v. Commission (Kali+Salz)* [1998] ECR I-1375 and in Case T-114/02 *BaByliss v. Commission* [2003] ECR II-1279.

⁷⁹⁴ *Airtours v. Commission*, supra, n. 652; *Schneider/ Legrand II* [2003] OJ C 29/5 and *Commission v. Tetra Laval* [2005] ECR I-987.

Firstly, the judgment broke new ground by potentially dismantling a joint venture that has been operating for two years, thus creating a spectrum of increased intervention and uncertainty after closed mergers and acquisitions. Secondly, the judgment also demonstrates the potential difference in merger tests between EU and USA akin to the *GE/Honeywell* scenario, because the US authorities approved the Sony/BMG venture without the issuance of a Second Request.⁷⁹⁵ It is also interesting that the CFI ignored the fact that the Sony/BMG joint venture had received the regulatory approval in the US by the FTC.

There are a number of positive points about the CFI's ruling, for example, without *Impala*, the 'poor' ruling on the Sony/BMG merger would not have been opposed. The judgment arguably represented the most significant development in the concept of collective dominance since *Airtours*. Importantly, in its judgment, the CFI showed that it was not imposing too a high standard of proof for the Commission, and the latter was perfectly able to meet such standard.⁷⁹⁶ Overall, this ruling created good dynamics between majors and independents. The CFI made an important point in rejecting the premise that a significant fall in demand for recorded music on CDs was a reason for a merger. This goes in line with the US reasoning in *Warner/PolyGram* in that financial weakness of the parties could not justify a merger. Thus, in the future, majors will not (or should not) be able to justify their mergers on grounds of financial difficulties.

Another positive outcome of the CFI's ruling is that in future the Commission is likely to demand more evidence from the merging companies, and take third party objections more seriously. Having said that, third parties often, being the competitors, seek to improve their own market position in an anti-competitive way.⁷⁹⁷ In *Impala*'s case, it does not look as if they opposed the Sony/BMG merger to create legal uncertainty, and consequently it cannot be argued that *Impala* sought to improve its market position in an anti-competitive way. It could be argued that there is a fine line between being a competitor opposing a merger and being an impartial party doing so in the interests of

⁷⁹⁵ See the glossary for the definition of 'Second Request'.

⁷⁹⁶ Van Rompuy Ben and Pauwels Caroline, "Is the Standard of Proof Imposed by the Community Courts Undermining the Efficiency of EC Merger Control? The Sony BMG Joint Venture Case in Perspective." *EUSA Tenth Biennial International Conference*, May 17 – 19, 2007, at pp. 1 – 33.

⁷⁹⁷ Preston McAfee and Nicholas Vakkur, "The Strategic Abuse of the Antitrust Laws." *Journal of Strategic Management Education* 2 (2005): 3 - 21. Often firms use the competition policy to defend their profit-maximising interests. See William J. Baumol and Janusz A. Ordover, "Use of Antitrust to Subvert Competition." *Journal of Law & Economics* 28 (1985): 247 – 266.

competition.⁷⁹⁸ This distinction is something that would need to be taken into consideration by the Commission in the future.

Regarding the future of the record industry and what this CFI's ruling may mean to both majors and independents, the judgment seems to have had little effect on the overall trend towards more concentration in the record industry. In the words of Patrick Zelnick, the *Impala v. Commission* was "a watershed in European Affairs, a landmark judgment for music. There is no doubt that it will block any further mergers and will transform how music and other creative sectors are treated".⁷⁹⁹ But will it indeed do so? As will be demonstrated in the following section, the Commission has given the second approval to the Sony/BMG merger.⁸⁰⁰ In a hypothetical but nevertheless common scenario where a major is acquiring a small, medium or even large-sized independent label, would that major record company be required to clear the acquisition with the Commission? It seems unlikely. Nevertheless, such acquisitions happen on an almost daily basis *without* the need of the Commission's involvement. Ironically, one year on after the CFI judgment, Universal, the biggest major record company in the world, in addition to acquiring the BMG publishing catalogue (with regulatory clearance), also acquired *eight* independent record labels⁸⁰¹ including Sanctuary Records⁸⁰² and V2⁸⁰³ in the UK, two iconic independent labels, *without* any regulatory procedures applying. The year of 2008 saw another acquisition of an independent label, 679 by Warner

⁷⁹⁸ As mentioned earlier, the basic premise of competition law is to protect competition, not competitors. See Eleanor M. Fox, "We Protect Competition, You Protect Competitors." *World Competition* 26, no. 2 (2003): 149; Sven Volcker and Cormac O'Daly, "The Court of First Instance's *Impala* Judgment: A Judicial Counter-Reformation in EU Merger Control?" *European Competition Law Review* 11 (2006): 589 – 596. Soon after its victory at the CFI, *Impala* challenged Universal's acquisition of the BMG's music publishing catalogue, *albeit* unsuccessfully. See *Impala*, "Impala Launches Consultation on Universal BMG Music Publishing Merger Concerns." November 13, 2006; *Impala*, "Impala Welcomes Second Stage Investigation into Universal BMG Music Publishing Merger." December 8, 2006; *Impala*, "Impala Statement on EC Approval of Universal BMG." May 22, 2007; and *Impala*, "Impala Challenges Universal's Creeping Dominance and Asks EC to Examine Sale of Publishing Assets." October 8, 2007.

⁷⁹⁹ *Impala*, "European Court Annuls Sony/BMG Merger. Independents Win Landmark Judgment." July 13, 2006.

⁸⁰⁰ *European Competition Commission*, "Mergers: Commission Confirms Approval of Recorded Music Joint Venture between Sony and Bertelsmann after Re-assessment Subsequent to Court Decision." October 03, 2007.

⁸⁰¹ The labels are Vale Music in Spain, ARS in Belgium, Magic in Poland, Lionheart in Sweden, Rounder Records in the UK. See also *Impala* (October 8, 2007), *supra*, n. 798.

⁸⁰² Lars Brandle, "UMG Seals Sanctuary Buyout Deal," *The Billboard*, August 02, 2007. This acquisition was followed by an immediate closure of Sanctuary's UK record business. Instead, Universal concentrated on the management of artists and merchandising activities. See Richard Wray, "Record Breaker UK Label Closes," *The Guardian*, September 6, 2007; Clare Matheson, "Music Giants Change Their Tune," *BBC*, September 13, 2007.

⁸⁰³ Ed Christman, "UMG to Acquire V2 from Morgan Stanley," *The Billboard*, August 10, 2007.

Music⁸⁰⁴ and the acquisition of Spanish label Univision by Universal *without* any regulatory consent.⁸⁰⁵ Therefore, it seems that there is no stopping Universal's and other majors' appetite for growth. There are other variations to the above scenario that entail expansion and growth that do not involve direct acquisition of independent labels. A major can instead sign numerous financing, licensing and distribution agreements with independents, which blur the idea of what an independent label is these days (as discussed in Chapter 3; some independents eagerly sign such deals, whereas others simply do not have a choice). That explains why even in the digital era the market share of the independents decreases, while the market share of the majors is on the rise. Thus, so far competition law has clearly not provided a solution for independents as it has failed to prevent high record industry concentration.

5.3.2.C. The Commission's Second Approval of Sony/BMG

Following the CFI's annulment of the Commission's decision, it was sent back to the Commission for re-assessment of the merger under the market conditions for 2007. In October 2007, the Commission confirmed clearance under the ECMR for the creation of SonyBMG.⁸⁰⁶

5.3.2.C.i. Legal Critique of the Approval

It must be stated that this time around it seems that the Commission did indeed undertake a complex analysis of the merger, which is reflected in the length of the ruling, some 339 pages, compared to the 54 pages of the original decision. The Commission took on board the remarks and criticism made in the CFI's judgment in considering whether the alleged collective dominant position was supported by any factual evidence. In this respect, Competition Commissioner, Neelie Kroes, noted: "this investigation represents one of the most thorough analyses of complex information ever

⁸⁰⁴ *The Record of the Day*, "Warner Music UK Acquires 679 Recordings." January 21, 2008.

⁸⁰⁵ Michele Gershberg and Gerald McCormick, "Universal Music Buys Univision's Music Unit," *Reuters*, February 28, 2008.

⁸⁰⁶ Case No COMP/M.3333-Sony/BMG, *supra*, n. 460. See also *European Competition Commission*, "Mergers: Commission Confirms Approval of Recorded Music Joint Venture between Sony and Bertelsmann after Re-assessment Subsequent to Court Decision." October 03, 2007; Nic Fildes, "Outcry as EC Greenlights SonyBMG Merger," *The Independent*, October 4, 2007; and Katie Allen, "SonyBMG Merger Cleared by Brussels," *The Guardian*, October 3, 2007.

undertaken by the Commission in a merger procedure”.⁸⁰⁷ The complex information included the vast numbers of econometric data analysing all net prices, discounts and wholesale prices for all CD chart albums sold by all major record companies in the EU between 2002 and 2006. Thus, in order to investigate whether the merger might significantly impede effective competition in the recorded music market, the Commission used the same, *albeit* very complex, economics-based analysis.

What is important in terms of the argument of this thesis is that in its approval ruling, the Commission decided that the economics-based approach was *not* enough and took into account *non-price* co-ordination in relation to such matters as “access to airplay, chart rules, release dates, and alleged negative impact on *cultural diversity*”.⁸⁰⁸ Having said that, the Commission was still reluctant to even use the term cultural diversity, and in fact it was used only four times in the approval (see the discussion of such a position below).

Naturally, in the second investigation, more attention was given to recorded music in digital formats and its on-line licensing. In 2007 the digital market was still an emerging market as it amounted to between 2 percent and 6 percent of all music sales in the 15 EU Member States.⁸⁰⁹ However, the Commission emphasised that the digital market has evolved significantly since the year of 2004 and represented a ‘dynamic market’.⁸¹⁰ Hence, in the opinion of the Commission, problems that existed in 2004 were not so relevant in 2007, e.g. the majors’ restrictive licensing behaviour in 2001 and associated with it US antitrust investigation (see more in Chapter 4). The Commission noted that, as of 2003, the majors started to license *their* digital content to third parties.⁸¹¹ The word ‘their’ is crucial because similarly to the first decision, the Commission focussed on the ease of access to the majors’ content by third parties. It did not go into the discussion of access to different content by different labels, i.e. preventing content uniformity.

⁸⁰⁷ *European Competition Commission*, id.

⁸⁰⁸ id.

⁸⁰⁹ Case No COMP/M.3333-*Sony/BMG*, supra, n. 460, at para 43.

⁸¹⁰ id., at para 79.

⁸¹¹ id., at para 47.

Similarly to the first decision, the Commission stated that the content accessed in a digital format was highly heterogeneous as every release was unique.⁸¹² It seems that when assessing whether the nature of the majors' content was diverse, the Commission again blindly took on board the information submitted by the parties.⁸¹³ Unfortunately, very few comments can be made on the issue of content diversity, as the data on SonyBMG's new releases in 2006 was confidential.⁸¹⁴ Having said that, the Commission stated that 90 percent of *chart* material originated from the majors⁸¹⁵ and that the supply of digital content by majors in the EU was 85 percent, whilst independents accounted for 15 percent.⁸¹⁶ It is strange, to say the least, that the number of chart hits (rather than diversity) was the main yardstick for the Commission. By contrast, as mentioned before, there were only four mentions of 'cultural diversity' in the approval compared to countless mentions of 'hits'.

However, in contrast to the first decision, in the approval, the Commission paid far greater attention to independent labels. For example, it found that the digital sector created growth opportunities for the independents too.⁸¹⁷ It is possible to agree that the digital sector creates *more* opportunities for independents, but they are unlikely to be described as *growth* opportunities. There is no doubt that the Internet represents a more level playing field between the majors and independents, but in the Commission's own words "promotion activities, signing up of new artists, vertical integration and international presence imply that majors will be more able to exploit a given record".⁸¹⁸ Obviously, the independents can upload their music on iTunes via a rights aggregator, but there are about 10 million songs in the iTunes store⁸¹⁹ and unless there is a good and costly PR, TV and radio marketing campaign, it is very difficult to be noticed by the consumers. Thus, it seems that the Commission has over-simplified the increasing role of the Internet, and it did not come as a surprise when the Commission found no co-ordinated effects amongst the majors. It is not to say that the Commission acted

⁸¹² *id.*, at para 50.

⁸¹³ *id.*, at para 117.

⁸¹⁴ *id.*, at para 507, table 14.

⁸¹⁵ *id.*, at para 54.

⁸¹⁶ *id.*, at para 82.

⁸¹⁷ *id.*, at para 55.

⁸¹⁸ *id.*, at para 91.

⁸¹⁹ *id.*, at para, para 427. The Commission stated the figure of 6 million songs for 2007. The data for 2009 informs that there are now about 10 million songs on iTunes. See Bobbie Johnson, "Apple Drops DRM Copy Protection from Millions of iTunes Songs," *The Guardian*, January 6, 2009.

unlawfully, but rather its analysis lacked the necessary depth into the problem of online sales.

The next step was to assess whether the merger has led to a creation or strengthening of a collective dominance on the wholesale market for licensing of music to digital music providers. In order to carry out the assessment, the Commission's market investigation examined to what extent the majors had aligned price levels in their contracts with digital music providers, and if such alignment had taken place, then was it because of the co-ordination between the majors or was it more to do with the high bargaining power of Apple (in relation to iTunes)? Here, once again the Commission has employed the tripartite *Airtours* test.

1) Transparency of Prices in Digital Markets

What worried the Commission the most were the uniform prices in digital markets. However, as the market investigation showed, it was the Apple corporation that was in control of setting the prices at 0.99 Euro, and therefore, it was outside of the majors' control.⁸²⁰ Secondly, the Commission found that the rapidity of new entrants and string of changing business models resulted in a lot of uncertainty in the digital market,⁸²¹ and as such price-fixing was not an issue.⁸²²

2) Retaliatory Measures

The Commission could not find an example of how retaliation could take place in the digital world given the nascent stage of the digital market,⁸²³ but for the sake of completeness it turned to examining the physical formats. It was held that with respect to compilation releases, their success depended on the popularity of the songs included in them, and therefore excluding "a major from a compilation could potentially hurt the retaliating majors more than the deviating major".⁸²⁴ The Commission also cited another reason in support for deeming compilations relatively unimportant was that in the digital world, the customers preferred to create their own compilations.⁸²⁵ That

⁸²⁰ Case No COMP/M.3333-*Sony/BMG*, supra, n. 460, at paras 51, 70, 71.

⁸²¹ id., at paras 56 – 58.

⁸²² id., at para 132.

⁸²³ id., at para 139.

⁸²⁴ id., at para 140.

⁸²⁵ id., at para 456.

seems logical and correct, but in the same ruling the Commission noted that the CD market still accounted for about 82 percent of global music sales,⁸²⁶ and therefore compilations still constituted an important part in the record business. To support its conclusion as to the lack of retaliation mechanism, the Commission used an example of Universal unilaterally reducing the prices of 1500 albums in 2006 without any retaliation by the remaining majors.⁸²⁷

3) Countervailing Abilities

In the previous sections, the Commission stated that owing to the Internet, independents had a more level playing field. However, when the Commission got down to assessing the countervailing abilities, it noted, “independents exert only *limited* competitive pressure on the majors, in particular as they produce a relatively small number of *chart hits* which are very important for digital music services”.⁸²⁸ Seemingly, independent labels offered little challenge to any potential co-ordination. With regards to the countervailing power of customers, it was rightly noted that Apple however, had a certain market power to react to potential co-ordination amongst the majors.⁸²⁹

Based on the above analysis, the Commission has ruled out the creation or strengthening of a collective dominance in the market for digital distribution of music.

For the sake of the fullness of the market investigation, the Commission also analysed price developments for the period from 2004 - 2007 on the basis of data received from the majors and the market share calculated by the IFPI. The investigation into the retail prices for downloads showed that they were fairly standardised⁸³⁰ due to the strong bargaining power of Apple.

Investigating recorded music in the physical format the Commission also noticed that the majors’ market shares have been relatively stable in the EU countries from 2000 – 2006,⁸³¹ however there was an unclear trend in terms of the digital age when in the majority of the EU countries, independents have lost their market shares (for more see

⁸²⁶ *id.*, at para 443.

⁸²⁷ Case No COMP/M.3333-*Sony/BMG*, *supra*, n. 460, at para 142.

⁸²⁸ *id.*, at para 145.

⁸²⁹ *id.*, at para 146.

⁸³⁰ *id.*, at para 166.

⁸³¹ *id.*, at para 411.

above on page 82). The Commission noted that the combined strength of independents varied from 42 percent in Portugal to 10 percent in Ireland.⁸³² The country-by-country analysis also showed that independents in the majority of the EU Member States continued to lose their market share,⁸³³ as is now also happening in the digital age. Therefore, the Commission overlooked the paradox that in the digital age, the market share of the independents has actually diminished. This should be seen in direct contrast to the Commission's findings that the Internet provides a more level playing field for the independents.

Importantly in terms of this thesis, the Commission for the first time considered the impact of the merger on artists and subsequently, cultural diversity.⁸³⁴ In doing so, the Commission examined the way in which majors handle and limit their catalogues and national repertoire, as well as focusing on promoting a tiny number of Anglo-American superstars through increasingly narrow retail channels, all of which affect consumer choice.⁸³⁵ It was revealed that SonyBMG did significantly *reduce* their artist rosters,⁸³⁶ but so did the other majors due to the decline in demand for a physical format. It was also noted that major record companies often sought to sign successful artists away from the independents they were contracted to because "majors are generally able to offer them better financial conditions".⁸³⁷ The Commission also noted that several artists have managed to become very successful through the Internet without the support of record companies, citing the examples of Sandi Thom, Lily Allen and the Arctic Monkeys.⁸³⁸ However, what the Commission's market investigation did not show was the well-documented fact that Sandi Thom was *not* a self-made Internet star, as had been publicised. In fact she had a £1million contract with RCA and cleverly used media stunts masterminded by her PR company.⁸³⁹ Similarly, Lily Allen had a deal with Parlophone first, and then used a PR company to create a buzz about her success

⁸³² *id.*, at para 414.

⁸³³ For the countries where the market share of independents has diminished see *id.*, at para 662 - the UK; para 799 - France; para 933 - Spain; para 997 - Austria; para 1054 - Belgium; para 1170 - Greece; para 1223 - Ireland; para 1443 - Finland; para 1497 - Sweden. However, in some countries, the independents' market share was on the increase: para 733 - Germany; para 1117 - Denmark; para 1277 - The Netherlands; para 1333 - Norway; para 1388 - Portugal.

⁸³⁴ *id.*, at para 415.

⁸³⁵ *id.*

⁸³⁶ *id.*, at para 416. The numbers are confidential.

⁸³⁷ *id.*, at para 420.

⁸³⁸ *id.*, at para 422.

⁸³⁹ Owen Gibson, "An Internet Superstar or Just Another Rock'n'Roll Swindle?" *The Guardian*, May 31, 2006; Daniel Melia, "Sandi Thom Revealed as a PR Stunt?" *Entertainment Wise*, May 30, 2006.

on MySpace.⁸⁴⁰ The same sort of background applies to the popular success of the Arctic Monkeys. These stories show how difficult it is for artists to break into the market and compete with highly promoted stars without the support of the record company. They also show that in some instances the Commission's investigation has not gone far enough and in some instances it could be said to be superfluous.

Nevertheless, based on its findings, the Commission concluded that the merger would not affect negatively cultural diversity at the level of music creation.⁸⁴¹ It is possible to agree that the merger would not have any impact on music *creation*; rather it is the diversity of the content delivered to the consumers that would be impacted upon. Moreover, it was noted that the merger had no negative impact on cultural diversity at the level of retail and distribution, as iTunes in Europe alone had about 10 million songs.⁸⁴² Once again, as explained earlier, it is relatively easy to upload content on to iTunes, what is difficult is spreading the word about it. In this sense, the digital world is not necessarily that much easier for the independents than the physical world.

Moving to the analysis of CD prices, the Commission noted that, "the PPDs of each album change several times within the life cycle of an album, leading to great difficulties for competitors to monitor this evolution of price".⁸⁴³ It was also shown that the PPDs were no longer published along sales charts in the majority of the EU Member States.⁸⁴⁴ However, 84 percent of the independent respondents in the market investigation thought that the PPDs were transparent as they still could be accessed via catalogues sent and the weekly updates that the majors e-mail out to retailers with information about new releases.⁸⁴⁵ About 61 percent of the respondents stated that majors were aware of each other's PPDs.⁸⁴⁶ The Commission validly pointed out that standard pricing was not unusual and that in fact many industries display a similarity in pricing for similar products, which has been seen in practice to be the case. It does, however, highlight the need to consider the importance of non-price issues in terms of the record industry (see the discussion below).

⁸⁴⁰ Gibson, *id.*

⁸⁴¹ Case No COMP/M.3333-*Sony/BMG*, *supra*, n. 460, at para 426.

⁸⁴² *id.*, at para 427.

⁸⁴³ *id.*, at para 462.

⁸⁴⁴ *id.*, at para 463.

⁸⁴⁵ *id.*, at para 466. Each e-mail contained information about the PPD.

⁸⁴⁶ *id.*, at para 467.

Furthermore, the Commission then moved to investigating the transparency of the discounts in the physical market. This time it was stated that file, campaign, and retrospective discounts were the most important discounts.⁸⁴⁷ However, unlike in the original decision, there was no mention of any invoice discounts. Nor was there any explanation as to why invoice discounts were no longer considered important. Upon investigation of the discount policies, the Commission concluded that there was no discount transparency.⁸⁴⁸

Having carried out a country-by-country analysis, the Commission held that the joint venture of Sony/BMG was compatible with the common market. Similarly to the first ruling, the merger was cleared unconditionally.⁸⁴⁹

5.3.2.C.ii. The SonyBMG Re-Approval: The Main Conclusions Regarding Cultural Diversity and the Importance of Non-Price Factors

This part focuses on the most important issue in terms of this study, which finally received some acknowledgement in the Commission's assessment, i.e. the non-price considerations.

In order to examine the market for recorded music, the Commission also carried out an in-depth market investigation, contacting customers and competitors in the 15 EU Member States.⁸⁵⁰ Part of the investigation included scrutiny of co-ordination at the level of *non-price* issues.⁸⁵¹ The point deserves special attention in this work being the first time that the Commission paid attention to non-price factors in the mergers between record companies, namely limiting independents' access to retailers and foreclosing independent competitors from access to airplay.

With respect to retailer access, the market investigation showed that any shelf space allocation was the decision of the retailers and was based "... on the perception of

⁸⁴⁷ *id.*, at para 477.

⁸⁴⁸ *id.*, at para 486.

⁸⁴⁹ In the past, the Commission approved a number of mergers based on certain conditions that the newly created entity was obliged to follow. See for example, Case No IV/M.2050 - *Vivendi/Canal+/Seagram* [2000] OJ C 311/3 and Case No COMP/M.1845 - *AOL / Time Warner* [2001] OJ L268/28.

⁸⁵⁰ Case No COMP/M.3333-*Sony/BMG*, *supra*, n. 460, at paras 525-6.

⁸⁵¹ *id.*, at para 532.

potential sales of each album. Record companies can have an influence by promoting albums and proposing high rebates, like in any industry, although the final decision remains within the staff of the retailer”.⁸⁵² The Commission seems to have rightly found no co-ordination in such an approach. The market investigation also showed the same conditions for both majors and independents to access the shelf space: “independents do not have more difficulties than major record companies in gaining access to shelf space and promotion space”.⁸⁵³ The paradox of this is that, on the one hand, it was stated that independents have the same chances of obtaining the shelf space as majors, but at the same time it is the retailer who makes the decision on the perception of *potential sales*. In the majority of cases, the potential sales will be higher with a major record company, as not every independent label can afford to pay huge amounts of money for the display, TV, and radio advertising etc. In fact, the Commission itself confirmed this by stating that, “it is logical from their [the retailers’] perspective to grant major record companies better access to shelf space, as they produce more *hits* selling large volumes”.⁸⁵⁴ It may be equally possible to access retail space for independents but it certainly is more expensive, and in most cases independents are unlikely to guarantee vast sales.

The problem of potential sales is also present in obtaining airplay. At the interview stage of this study, there were a couple of open questions about the positive and negative impacts of high concentration within the record industry. Interestingly, a number of respondents came up with similar answers, particularly on the subject of how difficult it is for the independents to obtain airplay. Two respondents provided nearly the same examples with BBC Radio 1: “when a record company goes to Radio 1, it is being asked how big is the budget for a particular song, how much does the video cost etc?”⁸⁵⁵ In the words of Keith Harris: “All that Radio 1 needs to ask itself is whether the song is good? What has a budget got to do with a good song?”⁸⁵⁶

The Commission’s market research rightly showed that most successful radio stations broadcast music on the basis of a playlist:

⁸⁵² *id.*, at para 606.

⁸⁵³ *id.*, at para 607.

⁸⁵⁴ *id.*, at para 610.

⁸⁵⁵ Interview with Janine Irons, *supra*, n. 342.

⁸⁵⁶ Interview with Keith Harris, *supra*, n. 370.

“As for the access to retail space, majors have a *privileged* access to radio play, reflecting the number of *hits* they release every year. It has also been submitted by one competitor that radio programmers prefer to work with the majors as they propose *hits* regularly, as opposed to the independents who propose one or two *hits* a year. Similarly one competitor submitted that majors have the financial capacity to advertise *hits* on TV or on radio, therefore increasing the demand for advertised titles and ultimately the likelihood that radio programmers put these titles on their play lists”⁸⁵⁷ (emphasis added).⁸⁵⁸

Following that, the Commission set out that the combined airplay for independents increased in 10 out of the 15 EU Member States: in some countries the airplay increased by 1 percent (Italy and Norway), in others by a maximum of 7 percent (Denmark and Sweden).⁸⁵⁹ Having considered such an important *non-price* issue as access to radio plays in just three paragraphs, the Commission concluded that there was no co-ordinated approach from major record companies with regard to airplay access.⁸⁶⁰ It seems that there is indeed no co-ordination among the majors in this respect, but the reason of why they manage to obtain easier access to airplay lies in their market power, i.e. their high concentration. Therefore, the Sony/BMG merger gave the parties a doubling of power to obtain both airplay and increased shelf space. It is unfortunate that the Commission did not look into that.

Thus, what seemed to be a promising start in the competition law development, turned out to be mere ‘surface treatment’ and an under-researched investigation into crucially important factors for the record industry. The Sony/BMG saga illustrated just how inadequate the merger regulation is in terms of preserving the competitive dynamics in the record industry. As this thesis focuses on competition law generally, the next chapter examines whether SMEs in cultural industries can seek redress under Articles 81 & 82 of the EC Treaty and from national trade offices.

⁸⁵⁷ Case No COMP/M.3333-*Sony/BMG*, supra, n. 460, at para 612.

⁸⁵⁸ *id.*, at para 611

⁸⁵⁹ *id.*, at para 613, footnote 191.

⁸⁶⁰ *id.*, at para 614.

Chapter 6: Articles 81 & 82 of the EC Treaty and Other Legal Tools Accommodating the Diversity of Products and Producers

The previous discussion identified that the EU merger regulation is orientated towards economic rather than cultural elements, with the main outcome being that both merger regulation and competition authorities have failed in preventing high concentration within cultural industries. Since the thesis is concerned with competition law overall, and not only merger regulation, this chapter will concentrate on other legal paths that could potentially protect producer and cultural diversity at the EU level, for example, Articles 81 and 82 of the EC Treaty. To date, Article 81 has had only marginal application in terms of the record industry. Therefore another cultural industry, namely the book publishing industry, was taken as an example to demonstrate the potential hurdles in protecting cultural diversity. For example, what would happen if a number of independent labels enter into a restrictive agreement in a certain territory? Could cultural needs be an exemption under Article 81(3) (discussed below)? The chapter will also consider the avenue of filing complaints to Member States' national trading bodies.

At present, as described above there is 'structure-related' merger analysis under the ECMR which looks at the future position (a forecast), but there is also the conduct-related analysis of anti-competitive agreements, i.e. Articles 81 and 82 of the EC Treaty (previously Articles 85 and 86 of the EC Treaty) which looks at the position already created (a retrospective analysis). The latter, retrospective test is a possible legal tool that could accommodate the issues concerning the diversity of musical products and producers.

One of the original principles and aims of the EU was the protection of undistorted competition throughout its territory. Recently, however, additional objectives have been introduced into the EC Treaty including Community policies that are not directly connected with the protection of competition, but are nevertheless considered crucial for the Community. These include policies regarding consumer and culture protection (see further below). It is, therefore, appropriate to analyse how Article 81 is placed to deal

with such consumer and culture protection and whether it could provide some redress where cultural issues are involved.

6.1. Article 81 of the EC Treaty

This section begins with a discussion of the provisions of Article 81 followed by a case study of book price-fixing to demonstrate the tension that exists between competition law and non-economic considerations such as culture and cultural diversity.

Article 81(1) of the EC Treaty prohibits the following, as being incompatible with the common market:

“all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade *between* Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market”.⁸⁶¹

Article 81(2) states that any agreements or decisions prohibited pursuant to Article 81(1) shall be automatically void. However, if an agreement falls within Article 81(1), it may not be void if it can satisfy certain conditions as set out in Article 81(3), which provides exemption on the basis that:

- i) an agreement contributes to improving the production or distribution of goods or to promoting technical or economic progress,
- ii) while allowing consumers a fair share of the resulting benefit, and which
- iii) does not impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives, and
- iv) does not afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

Thus, competition authorities may exempt a potentially restrictive agreement if it contributes to improving the production or distribution of goods or to promoting technical and economic progress and enabling consumers to benefit from it. These first two hurdles in particular open the door to public interest considerations (discussed below in this section). The provision relating to the imposition of restrictions signifies

⁸⁶¹ The Treaty establishing the European Community, 25 March 1957.

that an agreement should not contain any restrictions that are not indispensable, which could, for example, be price-fixing. Importantly, all *four* conditions must be satisfied for an agreement to be exempted from prohibition.⁸⁶² In addition, the resulting benefit should be something that manifests across the whole of the European Union, not just the parties involved in the agreement.⁸⁶³

Similarly to the reasons for the introduction of the new ECMR, having faced much criticism on its application of Article 81, the Commission adopted a *White Paper on Modernisation of Articles 81 and 82*.⁸⁶⁴ The *White Paper* suggested the decentralisation of power enabling national authorities to grant exemptions to potentially anti-competitive agreements under Article 81(3). Another important feature of the *White Paper* was that *non-economic political* considerations could not be assessed under Article 81(3) (see the discussion below). In addition to the *White Paper*, in 2004 the Commission adopted the *Article 81(3) Guidelines*,⁸⁶⁵ which re-emphasised the importance of *economic* analysis. However, the guidelines also mentioned an assessment by the Commission of the “likely impact of agreements on price, output, innovation, the variety or quality of goods and services”.⁸⁶⁶

What is important to note here is that there is no explicit mention in the text of Article 81(3) of any non-economic concerns, such as culture, variety, innovation but the Commission’s own clarifications and explanations on Article 81’s application suggest the need to consider these wider non-economic considerations. These issues have, understandably, created some tension in the interpreting and applying of Article 81(3).⁸⁶⁷

It is therefore difficult to assess what ‘*benefit*’ under Article 81(3) can exempt a restriction of competition under Article 81(1). This question is not an easy one as a balancing act is required between the objectives of *competition law* with that of the

⁸⁶² See joined cases T-528/93 - *Metropole Television SA v. Commission* [1996] 5 CMLR 386, at para 93.

⁸⁶³ Richard Whish, *Competition Law* (London: Butterworths, 2001), 125 and Cases 56/64 and 58/64 *Consten and Grundig v. Commission* [1966] CMLR 418, at p. 478; and *BT Astra SA* [1994] 5 CMLR 226, at para 22.

⁸⁶⁴ *White Paper on Modernisation of the Rules Implementing Articles 81 and 82*, [1999] 5 CMLR 208.

⁸⁶⁵ *Guidelines on the Application of Article 81(3) of the Treaty*, [2004] OJ C101/97.

⁸⁶⁶ See para 24 of the *Article 81(3) Guidelines*. For more details see Jonathan Faull and Ali Nikpay, *The EC Law of Competition* (Oxford: Oxford University Press, 1999), 265.

⁸⁶⁷ See for example, Okeoghene Odudu, “A New Economic Approach to Article 81(1)?” *European Law Review* 27, no. 1 (2002): 100 – 105.

other goals of the Community (which, in principle, are unrelated to the protection of competition, as such). The debate also involves another important issue as to whether it should be the Commission or the national competition authorities who decide on these *other goals* of the Community?⁸⁶⁸

With respect to Article 81, the test in ascertaining whether or not an agreement is anti-competitive, is one of *economic efficiency*.⁸⁶⁹ However, economic efficiency is *not* the only objective that is taken into account by the Commission. Occasionally, the Commission has taken on board *other goals* of the Community, e.g. the protection of small and medium-sized enterprises and cultural diversity.⁸⁷⁰ Such ‘dilution’ of Article 81 arose primarily when the Treaty of Maastricht (1991) added to the EC Treaty a number of crucial *non-economic considerations* into the EU *constitutional* tasks, for example, environmental protection (Articles 6, 174 – 176), industrial policy (Article 157), social policy and cohesion (Articles 158 – 162), employment (Article 127(2)) and *culture* (Article 151(4)) amongst them, the latter being noteworthy here. Thus, the controversial Treaty of Maastricht not only had a political angle but also added a cultural dimension to EU competition law.⁸⁷¹

Article 151(4) provides that “the Community shall take cultural aspects into account in its action under *other* provisions of this *Treaty*, in particular in order to respect and to *promote* the *diversity* of its *cultures*”. It would therefore follow that Article 151(4) should be considered when interpreting the assessment of potential anti-competitive agreements under Article 81. Article 151(4) makes it clear that the competition law decision makers ought to take cultural issues on board, but the problem is that it does not state exactly *how* or to *what* extent. One could also ask whether or not competition law could accommodate a cultural exception at all? The legal profession, namely the lawyers trying to follow a narrower interpretation of the legislation, may find it difficult to balance the competition goals of Article 81 with the non-economic goals of the

⁸⁶⁸ For more see Whish, *supra*, n. 863, at p. 125 and Giorgio Monti, “Article 81 EC and Public Policy.” *Common Market Law Review* 39, no 5 (2002): 1057.

⁸⁶⁹ Economic efficiency and welfare are *implicitly* recognised in Article 81(3), which states that potentially restrictive agreements may be exempted if ‘they improve the production and distribution of goods or promote technical or economic progress’. See also Motta, *supra*, n. 671, at p. 45.

⁸⁷⁰ *id.*, at pp. 16 - 17.

⁸⁷¹ Christoph Schmid, “Diagonal Competence Conflicts between European Competition Law and National Regulation – A Conflict of Laws Reconstruction of the Dispute on Book Price Fixing.” *European Review of Private Law* 1 (2000): 156 -7.

EU.⁸⁷² The reasons provided below explain why the supporters of the narrow interpretation of Article 81(1) have every right to defend their position.

6.1.1. Proponents of ‘Pure’ Competition Law or Its Narrow Interpretation

The narrow and legalistic view of reading Article 81(3) involves an assessment of the improvements of *economic* efficiency in a given agreement. In doing so the Commission, of course, aims to protect public interests too, but to what extent? Some scholars and practitioners insist that there is *no* room for exercising discretion under Article 81(3), i.e. non-competition considerations should play *no* role in the protection of competition between Member States. The others opine that although non-competition issues should not be imported into Article 81(3), they should be dealt with ‘at arm’s length’.⁸⁷³ The purists insist that the inclusion of *other* Community goals into Article 81(3) would weaken both its direct effect⁸⁷⁴ and ‘justiciability’;⁸⁷⁵ it is also argued that non-competition concerns alone would not be able to “redeem an agreement as anti-competitive”.⁸⁷⁶ Moreover, it is contended that had non-competition concerns been taken on board under Article 81(3), those third parties that pursue their own interests from time to time, would be able to jeopardise the impartiality of competition law. Finally, another sound argument for a narrow definition is that it offers better legal and commercial certainty because competition law impacts very much on the economy, and markets would rather see stability and predictability. These are all valid concerns and arguments. However, firstly, the EU competition law has not provided a definition of what ‘economical efficiency’ is;⁸⁷⁷ therefore this test, akin to the ECMR, is also uncertain in its application. Secondly, there is always a danger for the Commission to be influenced by pressure from third parties, even under the economic efficiency test. Nevertheless, presently, the Commission *insists* on a *narrow* interpretation of Article 81(3):

⁸⁷² *id.*, at p. 165.

⁸⁷³ Assimakis P. Komninos, “Non-Competition Concerns: Resolution of Conflicts in the Integrated Article 81 EC.” *The University of Oxford Centre for Competition Law and Policy Working Paper*, (L) 08/2005.

⁸⁷⁴ Direct effect signifies that any court or tribunal can apply the law.

⁸⁷⁵ See Ulrich Immenga, “Coherence: A Sacrifice of Decentralisation?” in *European Competition Law Annual 2000: The Modernisation of EC Antitrust Policy*, ed. Claus Dieter Ehlermann and Isabela Atanasiu (Oxford: Hart Publishing, 2001), 355.

⁸⁷⁶ Komninos, *supra*, n. 873, at p. 8.

⁸⁷⁷ Damien Geradin, “Efficiency Claims in EC Competition Law and Sector-Specific Regulation.” *The Social Science Research Network* (2004): 4.

“...the structure of Article 81 is such as to prevent greater use being made of this approach [the need to ensure consistency between competition policy and other Community policies]: if more systematic use were made under Article 81(1) of an analysis of the pro- and anti-competitive aspects of a restrictive agreement, Article 81(3) would be cast aside, whereas any such change could be made only through revision of the Treaty. It would at the very least be paradoxical to cast aside Article 81(3) when that provision in fact contains all the elements of a ‘rule of reason’. It would moreover be *dangerous* if modernisation of the competition rules were to be based on developments in *decision-making practice*, subject to such developments being upheld by the Community Courts. Any such approach would mean that modernisation was contingent upon the cases submitted to the Commission and could take many years. Lastly, this option would run the risk of diverting Article 81(3) from its purpose, which is to provide a *legal framework* for the economic assessment of restrictive practices and not to allow application of the competition rules to be set aside because of *political considerations*” (emphasis added).⁸⁷⁸

This passage confirms that the Commission is prepared to consider some balancing between the pro- and anti-competitive *economic* aspects of an agreement under Article 81(1). However, it clearly states that the agreements should be assessed only under Article 81(3) exemptions.⁸⁷⁹ As such it would follow that non-economic considerations should *not* be the primary factor in deciding how to carry out an assessment under Article 81 (3), although such considerations do not seem to be precluded from being taken into account.⁸⁸⁰

Similarly, in its *Guidelines on the Applicability of Article 81*, the Commission noted that: “the four conditions of Article 81(3) are...*exhaustive*.... Goals pursued by other Treaty provisions *can* be taken into account *to the extent* that they can be *subsumed* under the *four conditions* of Article 81(3)”.⁸⁸¹

6.1.2. Proponents of the Wider Reading of Article 81(3)

Despite the Commission’s desire to read the provisions of Article 81(3) narrowly, there are supporters of a wider application⁸⁸² the Article. The proponents of the broader

⁸⁷⁸ See the *White Paper*, supra, n. 864, at para 57.

⁸⁷⁹ Claus Dieter Ehlermann, “The Modernisation of EC Antitrust Policy: A Legal and Cultural Revolution.” *Common Market Law Review* 37 (2000): 549.

⁸⁸⁰ *id.*

⁸⁸¹ *Guidelines on the Applicability of Article 81 of the EC Treaty to Horizontal Cooperation Agreements*, [2001] OJ C 3/2, at para 42. See also Lars Kjolbye, “The New Commission Guidelines on the Application of Article 81(3): An Economic Approach to Article 81.” *European Competition Law Review* 9 (2004): 571.

⁸⁸² For example, Jonathan Faull noted that social policy could ‘reasonably credibly’ be brought within Article 81 (3). Also cited in Whish, supra, n. 863, at p. 125, footnote 6. For more details see Rein Wesseling, “The Commission White Paper on Modernisation of EC Antitrust Law: Unspoken

interpretation of Article 81(3) insist that the latter should be more than just about the assessment of economic efficiency and it could take into account *other goals* of the Community. Their basis for defending such a position can be found in Article 151(4), which states that: “the Community shall take *cultural aspects* into account in its action under *other* provisions of this *Treaty*”. Therefore, Article 81 could be interpreted as *other* provisions of the EC Treaty.

These other goals of the EC Treaty clearly have far reaching consequences, and have been argued as being as important, if not more important, than the improvement of economic efficiency.⁸⁸³ Going back to the issues raised in Chapter 1, the inclusion of culture into the EC Treaty is characterised through balancing the principles of economic efficiency and that of preserving cultural diversity.⁸⁸⁴ For example, as shown in Chapter 3, record labels have economic strength in terms of the revenue they contribute to the economies of Member States. However, as demonstrated in Chapter 1, the products of those record labels are also important from the cultural point of view because they are intellectual, artistic works, which also happen to require financial investment. The mixture of an intellectual and a financial investment makes it more difficult to draw a line between economy and culture, let alone describing how the law should accommodate and protect them. Arguably, Article 151(4) has not resolved this tension, but as the analysis of book price-fixing below will show, it has only complicated the matter by giving culture more weight under the EC Treaty without specifying *how* cultural diversity should be protected when it collides with other compelling goals of the Community.⁸⁸⁵

The dualism of Community aspirations is illustrated by the fact that on the one hand, there is the desire to achieve a single market and economic efficiency for music

Consequences and Incomplete Treatment of Alternative Options.” *European Competition Law Review* 20, no. 8 (1999): 420 – 433; Ben Van Houtte, “A Standard of Reason in EEC Antitrust Law: Some Comments on the Application of Parts 1 and 3 of Article 85.” *Northwestern Journal of International Law and Business* 4 (1982): 510; Mario Siragusa, “Rethinking Article 85: Problems and Challenges in the Design and Enforcement of the EC Competition Rules,” in *International Antitrust Law and Policy 1997, Annual Proceedings of the Fordham Corporate Law Institute*, ed. Barry Hawk (New York, Juris Publishing, 1998), 285; and Giorgio Monti, “New Directions in EC Competition Law,” in *European Union for the Twenty-First Century: Rethinking the New Legal Order*, ed. Takis Tridimas and Paolisa Nebbia (Oxford: Hart Publishing, 2004), 188 – 190.

⁸⁸³ Whish, *supra*, n. 863, at p. 126.

⁸⁸⁴ See also Anna Herold, “EU Film Policy: Between Art and Commerce.” *European Diversity and Autonomy Papers* – EDAP 3 (2004), 1 - 21.

⁸⁸⁵ Bruno de Witte, “The Cultural Dimension of Community Law,” in *Collected Courses of the Academy of European Law*, EUI Florence Vol. 1 (The Hague: Martinus Nijhoff Publishers, 1993), 272. Also cited *id.*, at p. 8.

products; on the other hand, there exists the Community ambition to promote and protect cultural diversity. Thus the first goal is of an economic nature that involves economies of scale, industrialisation of the recording process and standardisation of cultural products. These factors all contribute to a uniformity of cultural output,⁸⁸⁶ whereas the second goal poised by the Community is of the qualitative nature aimed at the production of diverse products.⁸⁸⁷ The diversity of recorded music output clearly has a cultural impact although the ability to ensure this diversity comes from more separated business practices and production by different labels would not necessarily result in economic efficiency. Hence it is difficult to see how the economies of scale can co-exist with heterogeneous products. Some even argue that those two goals of the Community cannot co-exist with each other.⁸⁸⁸ Not surprisingly, the introduction of the new non-economic concerns has triggered numerous conflicts and debates about how far the law can and should go to protect such concerns.⁸⁸⁹

More importantly, it is not just the academics that have debated over the broader reading of Article 81(3). The Commission itself has considered some of those non-economic issues (in most of those cases, the non-economic outcome could have been measured). For example, the Commission recently has ruled on cases when environmental protection was also considered⁸⁹⁰ demonstrating that where “a cleaner environment can be the basis for an exemption: the interests of the *citizen* may trump those of the *consumer*”.⁸⁹¹ In previous years, the Commission also considered industrial

⁸⁸⁶ *id.*, at p. 10.

⁸⁸⁷ *id.*, at p. 9.

⁸⁸⁸ *id.*, at p. 12; Psychigiopoulou, *supra*, n. 731, at p. 838.

⁸⁸⁹ The *White Paper* fuelled the ongoing debate as to whether the Commission should adopt the US’ ‘rule of reason’. Under the relevant US antitrust law, namely the Sherman Act, a restraint of trade is prohibited, although it is accepted that certain restraints can and do promote competition. As such the US antitrust authorities look to the *overall* effects on competition of an agreement, with the agreement being cleared if certain pro-competitive effects result from it. Article 81 is designed differently as it first prohibits ‘all agreements which restrain competition’ and then provides the four exemptions to that prohibition in Article 81(3). Article 81’s construction has caused much debate amongst scholars and practitioners, as regards whether non-economic considerations should defeat the prohibited agreement (akin to the US ‘rule of reason’); however the ‘rule of reason’ debate is outside the scope of this study. For more details see Wesseling, *supra*, n. 882, at p. 422.

⁸⁹⁰ *KSB/Goulds/Lowara/ITT* 91/38/EEC [1991] OJ L19/25, at para 27; *Assurpol*, 92/96 [1992] OJ L37/16, at para 38; *EACEM* No IV/C-3/36.494 [1998] OJ C 12/2, at paras 11 - 12; *DSD* 2001/837/EC [2001] OJ L 319/1, at paras 142 - 146. It must be stressed that in all those cases, the Commission exempted the agreements because they fell into the caveat of either consumer benefit or technical and economic progress. However, the Commission considered the environmental goals of the Community in respect of benefiting present and future generations, for example *CECED* [2000] OJ L 187/47; *Philips – Osram* [1994] OJ L378/44, at para 27; *Asahi/Saint-Gobain* [1994] OJ L1994/94, at paras 24-6 and *Exxon/Shell* [1994] OJ L 144/36, at para 68.

⁸⁹¹ *Monti*, *supra*, n. 882, at p. 189

policy concerns,⁸⁹² employment policy,⁸⁹³ and crucially in terms of this thesis, cultural policy as well. For example, in *United International Pictures*,⁸⁹⁴ the Commission took into account cultural policy and exempted an agreement that could potentially jeopardise European film industry on the condition that UIP would invest in production of European films.⁸⁹⁵ In the *Eurovision* case,⁸⁹⁶ the Commission applied an exemption to an agreement made between public broadcasters, which enabled smaller broadcasters to show sports programmes with an educational angle.⁸⁹⁷

Moreover, the Commission itself argued that it *was* possible to take into account goals and policies *other* than those expressly stated in Article 81(3).⁸⁹⁸ Another example of the Commission going beyond the pure assessment of economic efficiency is its recognition of the need and importance to promote diverse sporting activities throughout the Community.⁸⁹⁹ Interestingly, the ECJ too has stated that, “the practice of sport is subject to Community law insofar as it constitutes an *economic* activity”.⁹⁰⁰ However, it has also been argued that the application of competition rules should take on board the special character of sport⁹⁰¹ because “sport is not only an economic activity, it is also a social activity practised by millions of amateurs and one which plays a positive role in society: improvement of health, recreation, bringing people together and also training for the young, notably in difficult social areas”.⁹⁰² Therefore, it is argued that when considering the criteria for possible exemption, the particular characteristics of sport should be taken into consideration.

⁸⁹² Case IV/M.315 - *Mannesmann/Vallourec/Ilva* [1994] OJ L 102/15; *KEWA* [1976] OJ L51/15; *G.E.C.-Weir Sodium Circulators* [1977] OJ L327, 26; and *Carbon Gas* [1983] OJ L 376/19.

⁸⁹³ Case 26/76 - *Metro SB-Großmärkte GmbH & Co. KG v. Commission*, [1977] ECR 1875; and *Synthetic Fibers*, [1984] OJ L207, 17.

⁸⁹⁴ [1989] OJ L 226/25.

⁸⁹⁵ Although according to some scholars, the Commission failed to protect cultural diversity in the *UIP* case. See Psychigiopoulou, *supra*, n. 731, at p. 849.

⁸⁹⁶ *EBU/Eurovision System* [1993] OJ L 179/23. The case was later annulled by the Court of First Instance but on different grounds (Cases T-528, 542, 543 & 546/93 *Metropole Television SA v. Commission* [1996] ECR II- 649).

⁸⁹⁷ For more details see Rein Wesseling, *The Modernisation of EC Anti-Trust Law* (Oxford: Hart Publishing, 2000), 95 - 96.

⁸⁹⁸ In that particular case, the Commission argued for the importance of ‘maintenance of employment’. See Case T-17/93 - *Matra Hachette v. Commission* [1994] ECR II-595, at para 96.

⁸⁹⁹ *EBU/Screensport* [1991] OJ L63/32 and Case No. IV/36.33 - *KNVB/SPORT*, 7.

⁹⁰⁰ Case 36/74 - *Walrave and Koch v Union Cycliste Internationale* [1974] ECR 1405.

⁹⁰¹ Jean-Francois Pons, “Sports and European Competition Policy.” *Fordham Corporate Law Institute*, (1999), 17.

⁹⁰² *id.*, at p. 6.

In the past, the Commission also took on board various social reasons when considering an exemption under Article 81(3). One of the best examples of the Commission considering social policy as outweighing economic efficiency is *Ford / Volkswagen* case. In this case the Commission exempted a joint venture entered into between Ford and Volkswagen to manufacture a mini-van. Although, the joint venture should have failed on competition grounds, it was exempted on social grounds:

“...the project constitutes the largest ever single foreign investment in Portugal. It is estimated to lead, *inter alia*, to the creation of about 5,000 jobs and indirectly create up to 10,000 jobs, as well as attracting other investment in the supply industry. It therefore contributes to the promotion of the harmonious development of the Community and the *reduction of regional disparities*, which is one of the *basic aims* of the Treaty. It also furthers European market integration by linking Portugal more closely to the Community through one of its important industries”.⁹⁰³

Moreover, the CFI also on occasion backed up the Commission’s broader interpretation of Article 81(3): “the Commission is entitled to base itself on considerations connected with the pursuit of the public interest”.⁹⁰⁴

Therefore, without a *clear* mention of cultural issues in the body of Article 81, the assessment of non-economic matters is definitely not a clear-cut issue. As to date, Article 81 has been invoked once in terms of the record industry, namely in the George Michael case. In the *Panayiotou* case, George Michael alleged that his recording contract with Sony was void on the basis that it infringed Article 81(1). The judge held that Article 81 was not infringed, as the recording contract did not have a sufficiently significant effect on inter-member state trade. This conclusion was debatable, but the case was then settled in advance of any further appeal.⁹⁰⁵ A salient example on the

⁹⁰³ Case IV/33.814 - *Ford/Volkswagen* [1993] OJ L 20/14, at para 36.

⁹⁰⁴ T-528/93 - *Metropole Television SA v. Commission* [1996] ECR II-649, at para 118.

⁹⁰⁵ See *Panayiotou and Others v. Sony Music Entertainment (UK) Limited*, supra, n. 617. For more details on the case see Alan Coulthard, “Panayiotou v. Sony Music Entertainment (UK) Ltd Times, June 30, 1994 (Ch D).” *Journal of Business Law* (1995): 414 – 422; Jeremy Dickerson, “The Article 85 Implications of the George Michael Judgment.” *European Intellectual Property Review* 16, no. 10 (1994): 445 – 448; Michael A. Smith, “Restraint of Trade in the Music Industry.” *Entertainment Law Review* 5, no. 5 (1994): 182 – 187; *European Competition Commission*, supra, n. 608. Additionally, a number of cases showed how an interpretation of Article 81 could extend to consider the territorial restrictions and price-fixing in terms of record industry. These cases, although worth noting as regards the application of Article 81 to the record industry, did not explore the issue of cultural diversity. (i) The case of *MTV Europe v. BMG Records* [1997] 1 CMLR 867 involved a price-fixing agreement that was alleged to constitute an abuse of a dominant position under Article 81. The case was first notified to the Commission, and then secondly to the UK High Court in order to ascertain damages in favour of MTV. However, the High Court judge put the UK proceedings on hold until the Commission could first reach its decision under Article 81. (ii) In 2007, the European Commission has sent a Statement of Objections (to the companies concerned) alleging that the existence of certain agreements between major record

tension between *competition law* and *non-economic considerations* can be seen from the resale price maintenance of books. This example is of interest for a number of reasons: (i) the clash between the protection of competition (price-fixing) and the protection of culture (diversity and quality of books); (ii) books, being cultural products like music records, have a dual nature: they embody both cultural as well as economic values; (iii) the analysis of book price-fixing will also help draw parallels as to what extent Article 81(1) and (3) can regulate competition concerns in the record industry. For that reason, the next part provides an outline of the conflicts and issues faced in this example.

6.1.3. Case Study on Resale Price Maintenance in Book Selling

As mentioned above, books are akin to music records: they are both economic and cultural products and they do not have close substitutes. This case study will demonstrate that on the one hand book price-fixing protects the publishers and retailers and allows them to invest in a diverse range of books (innovation), but on the other hand it restricts competition. This dichotomy creates the tension within competition law, i.e. how and if at all law should resolve the cultural dilemma?

Resale price maintenance (price-fixing) occurs when “a distributor of a specific product enters into an agreement not to sell that product at a price less than assigned by the manufacturer”.⁹⁰⁶ Thus with respect to book price-fixing, the bookseller agrees not to sell the books *below* a certain price specified by the publisher. There are two types of book price-fixing: the one imposed by the state and the one enforced by the market participants. Both types of price-fixing have been used by Member States in the past as well as being used still in the present. In EU competition law the price-fixing agreements are *per se* prohibited under Article 81(1). However, as already stated, Article 81(3) can provide an exemption of the basis of its four conditions being satisfied.

companies and Apple violate the EC Treaty's rules prohibiting restrictive business practices (i.e. Article 81). These agreements limit consumers to only be able to buy music from the iTunes on-line store in their own country of residence, thus limiting them as to where to buy music, what music they can buy and the price applied. See *supra*, n. 608.

⁹⁰⁶ Mikheil Gogeshvili, “Resale Price Maintenance – A Dilemma in EU Competition Law.” *Georgian Law Review* 5 (2002): 281.

1) Publishers' and Booksellers' Arguments

The main rationale for allowing book price-fixing is “to guarantee a diversified, equable and country-wide supply of the cultural good, the book”.⁹⁰⁷ The publishers justify price-fixing on the grounds that it helps promote the diversity of both titles and booksellers, with publishers being able to invest in the publication of the less commercially attractive titles along with bestsellers, i.e. without price-fixing publishers would not be able to cross-subsidise less popular books by their bestselling books. Publishers claimed that without such subsidisation, both the diversity of titles and the opportunity for new writers to publish their works would reduce. For the booksellers, price-fixing was viewed as necessary in order to allow a broad range of titles to exist on the market, through the ‘bestsellers’ subsidising the slower selling books.⁹⁰⁸ These arguments emphasise the importance of book price-fixing from a cultural point of view. Apart from the cultural arguments, publishers also put forward economic justification for price-fixing, arguing that other players in the market, such as supermarkets and big book chains who were in a position to charge less for the same books, could and would therefore reduce the opportunities of other booksellers, who could not match them. Akin to the record industry majors, supermarkets operate on the economy of scale, which affords them selling bestsellers at very low prices. The main fear from the economic point of view was that the removal of resale price maintenance would lead to higher concentration in both publishing and bookselling. Supporters of price-fixing feared that small booksellers would disappear with the arrival of big chain bookstores (this is what is already happening in the US, see above page 37). Thus, this economic argument was intertwined with the cultural argument, i.e. that the preservation of small and local booksellers with a wide range of titles would benefit both consumers and culture. This should be seen in contrast to the supermarkets, which display only a dozen bestselling books, thus limiting the consumers’ choice as well as the dissemination of culture. Overall, book price-fixing was claimed to be necessary for the protection of cultural diversity.⁹⁰⁹

⁹⁰⁷ Schmid, *supra*, n. 871, at p. 158. For more on price-fixing in books see Christine Zandvliet, “Note: Fixed Book Prices in the Netherlands and the European Union: A Challenge for Community Competition Law.” *Columbia Journal of European Law* 3, no. 3 (1997-98): 413 - 453.

⁹⁰⁸ *Organisation for Economic Co-operation and Development*, “Resale Price Maintenance.” (1997): 110.

⁹⁰⁹ *id.*

2) The Position of the Commission towards the Arguments for Book Price-Fixing

The Commission analysed book price-fixing from a different angle though. Firstly, it was of the opinion that the situation with booksellers was more to do with market access, the cultural issue being cleverly tied into the market access argument. Secondly, the legal angle was that cross-subsidies⁹¹⁰ could actually diminish the incentives for publishers to innovate.⁹¹¹ Thirdly, and more importantly, from the economic and legal perspective, resale price maintenance excluded price competition between booksellers.⁹¹² Additionally, there are always a number of publishers and booksellers who do not release ‘high quality’ titles at all. Thus, demonstrating why the book industry should have benefited from fixed price protection was a big hurdle.

All of these arguments have been raised in one of the landmark cases in book price-fixing, *VBVB & VBBB*,⁹¹³ where both Flemish and Dutch publishers failed to justify an agreement, under which the booksellers in one country had to comply with the prices fixed by the publishers in the other country. The final decision made in this case was that resale price maintenance had the effect of depriving consumers of choice and prevented them from seeking lower priced books. The Commission reasoned that the majority of publishers in any case concentrated on bestsellers, which in turn should enable them to invest in less commercial titles. As such the publishers and booksellers needed to prove that without price-fixing they would not be able to sell as much ‘commercially unattractive’ titles as they would under a price-fixing regime. The Commission was of the opinion that, in *VBVB & VBBB*, that had not been proved. In this case, the Commission rejected considering cultural policy issues in whether or not to grant an exemption.

Nevertheless, in 1998 the Commission launched an investigation into resale price maintenance in bookselling. The then Commissioner Karel van Miert took a categorical anti price-fixing stance for the simple reason that it restricted competition and the publishers had not provided sufficient evidence that book price-fixing benefited consumers (which would then potentially give grounds for an exemption under Article

⁹¹⁰ Cross-subsidies mean the finance of the losses on unsuccessful books by bestselling books.

⁹¹¹ Marja Appelman, “Fixed Book Price,” in *A Handbook of Cultural Economics*, ed. Ruth Towse (Cheltenham: Elgar, 2003), 238.

⁹¹² *id.*, at p. 239 and *supra*, n. 908, at p. 110.

⁹¹³ *VBVB/VBBB* [1982] OJ L54 36, which was later upheld by the ECJ in *VBVB v. Commission* [1984] ECR 19, see particularly para 56.

81 (3)).⁹¹⁴ The Commission championed the argument that cheaper books (sold for example in supermarkets) would benefit the consumers because more people would be able to afford them and therefore access them more easily. However, a contra-argument can be advanced as to the narrow choice of titles sold (at cheap prices) in the supermarkets. Nevertheless, in 2000 the EU prohibited resale price maintenance in bookselling, which only affected the trade *between* Member States.⁹¹⁵ However, many Member States have kept the practice of resale price maintenance within their territories.⁹¹⁶

As shown in the *Organisation for Economic Co-operation and Development Report*, the evidence as to the effectiveness of resale price maintenance is indeed inconclusive.⁹¹⁷ In certain Member States, it was found that where there was an absence of any resale price maintenance agreements, there was a wider range of book titles than in the other Member States, which allowed the price-fixing agreements. For example, in Finland, price-fixing was abolished in 1971. Despite that, the number of book titles published in Finland rose from 3,350 in 1970 to 12,400 in 1994.⁹¹⁸ In France, however, price-fixing was abolished in 1979 but then re-introduced in 1992 because supermarkets started publishing their own paperbacks at a cheaper price, thus disadvantaging other publishers and booksellers.⁹¹⁹

The case of book price-fixing demonstrates the roots of the clash between law and culture because it shows that “any assessment of the economic and cultural consequences.... is highly uncertain”.⁹²⁰ The problem is that Article 151(4) only provides the competition authorities with minor competence to take cultural issues on board; it does not provide “a cultural exception to competition law”.⁹²¹ The example of resale price maintenance in book selling has illustrated that Article 151(4) does not give the Commission a complete legislative competence; culture and cultural diversity seem to be of limited consequence in the context of wider competition considerations because

⁹¹⁴ Quoting Karel van Miert. Also cited in Schmid, *supra*, n. 871, at p. 159. See also the *EU Council*, “Resolution on Fixed Book Prices in Homogenous Cross-Border Linguistic Areas.” [1999] OJ C 42/3.

⁹¹⁵ The resale price maintenance is considered to be a hardcore restriction under the Block Exemption Regulation. See Guidelines on Vertical Restraints [2000] OJ C 291.

⁹¹⁶ For example, in Germany and Netherlands the book prices are fixed by private agreements, whereas in France they are fixed by law.

⁹¹⁷ See *Organisation for Economic Co-operation and Development*, *supra*, n. 908, at pp. 112 – 114.

⁹¹⁸ *id.*, at pp. 112 – 113.

⁹¹⁹ *id.*

⁹²⁰ Schmid, *supra*, n. 871, at p. 171.

⁹²¹ *id.*, at p. 161.

even though the EU is encouraged to promote the cultural diversity of its Member States, it does not have a specific legal instrument to do so.

Primarily, the above section demonstrated that potentially Article 81 could, in some cases, also protect individual interests (independent labels), not only the wider, public interest.⁹²² Therefore, in principle there is nothing to stop independent music labels to seek redress under Article 81 (for more details see the Conclusion).

6.2. Article 82 of the EC Treaty

Article 82 bans “any abuse by one or more undertaking of a dominant position...in so far as it may affect trade between Member States...”. Due to the fact that Article 82 uses a dominance test, it is of less importance at present, as the new collective dominance test has arguably replaced Article 82. Therefore, it is outside the scope of this research.⁹²³

6.3. Complaints to the National Trading Authorities

If independent labels have concerns with respect to a certain joint venture and they cannot obtain all the evidence in order to file action under the EU competition regime, then it is possible to file a complaint about a particular merger or acquisition to the national trading authorities, such as the OFT in the UK. For example, the Association of Independent Music raised its concerns with the OFT in 2007 regarding the acquisition by Universal of Sanctuary and V2.⁹²⁴

This chapter has shown how Article 81 of the EC Treaty as it currently stands, may not provide adequate protection to cultural industries. Independent labels and their trade

⁹²² William J. Baumol and Janusz A. Ordover, “Use of Antitrust to Subvert Competition.” *Journal of Law and Economics* 28 (1985), 262.

⁹²³ For the analysis of collective dominant position under Article 82 see Heiko Haupt, “Collective Dominance under Article 82 EC and EC Merger Control in the Light of the Airtours Judgment.” *European Competition Law Review* 23, no. 9 (2002): 438-9; Mark Jephcott and Chris Withers, “Where to Go Now for EC Oligopoly Control?” *European Competition Law Review* 22, no. 8 (2001): 303; Lorna McGregor, “The Future for the Control of Oligopolies Following *Compagnie Maritime Belge*.” *European Competition Law Review* 22, no. 10 (2001): 437.

⁹²⁴ See BBC, “Indie Labels Attack Record Merger,” October 1, 2007; *Office of Fair Trading*, “Completed Acquisition by Centenary Music Holdings Limited of V2 Music Group Limited , No. ME/3280/07.” November 13, 2007; *AIM*, “AIM Responds to the OFT about the Universal’s Acquisition of V2 and Sanctuary.” October 1, 2007.

bodies could seek redress under Article 81, but without the specific mention of cultural interests, the competition law authorities can do little to protect cultural diversity.

It leaves me to re-iterate the importance of non-price competition and non-economic considerations in terms of competition law assessment. Therefore, the Conclusion of this study re-emphasises once more why the record industry should not be assessed only on price merits, and should contain other measures that could be used by competition law to re-instate competitive dynamics in the record industry.

Conclusion

“A hundred years ago, the public demanded antitrust legislation to protect it against the monopoly practices of railroads, grain millers, and the big banks. A different type of regulation may be required today, but the need to safeguard *thought* and *consciousness* against private monopoly is just as urgent”.

Herbert I. Schiller⁹²⁵

The Relationship between Cultural Diversity and Independent Music Labels

This study sought to investigate and reveal whether or not competition law has managed to protect cultural diversity, and has shown that in most cases, the law fails in preventing high concentration within the record industry and such concentration is inversely connected with diversity levels.

The research has demonstrated the importance of cultural diversity in terms of the development of intellect and values and is thus crucially important for society overall. The significance of cultural diversity can be drawn, not only from the opinions of numerous scholars but also from international treaties such as UNESCO’s Convention on Cultural Expressions and Article 154 (1) of the Maastricht Treaty. As exemplified in Chapter 1, numerous researches looking into the relationship between music diversity and concentration levels in the record industry have shown an inverse connection between them. Interestingly from this thesis’ point of view, the same inverse relationship was found within other types of cultural industries, for example within both the film and bookselling industries. These examples underline the fact that the protection of cultural diversity is of legitimate concern. As argued in Chapter 1, regulation of the record industry (as well as other types of cultural industries) by competition law seems to be the most efficient way to balance competitive dynamics in the market place. However, the thesis also highlighted the fact that the protection of cultural diversity is not a stated aim of competition legislation.

⁹²⁵ Schiller, *supra*, n. 137, at p. 171.

Alongside the prevalent notion of cultural diversity, this study has shown that the independent record sector as a cultural industry deserves special protection through competition law. Both the historical analysis and the interviews with record industry insiders demonstrated the importance of small businesses in terms of delivering cultural diversity to consumers, and the importance of small businesses for the overall economy (see Chapters 1 and 3). However, this research also emphasised that the protection of cultural diversity should not be dependent upon the economic parameters and profit making of cultural industries. Cultural products carry a broader context than a traditional economic transaction. Hence, cultural industries deserve protection because of their cultural input (which is often difficult to measure) rather than their economic potential (which is easier to measure).

The study has highlighted a relationship between cultural diversity and SMEs: the protection and the availability of cultural diversity (diversity of products) is directly connected with the protection and number of small independent labels (diversity of producers). It was also argued that even if there were one major company releasing all genres of music, the music market would still be not as diverse as having a myriad of small labels specialising in their own genre and music. Both the historical analysis and the interviews have shown that small labels were crucial agents in discovering and delivering diverse music to consumers. The interviews have also exposed the organisational and behavioural differences between majors and independents, which also lead to increased cultural diversity. For example, no need for the economy of scale, risk taking in terms of new genres and the speed of decision-making are hallmarks of independents. Therefore, SMEs in the cultural sector need supporting by governments and legislators, which in turn will lead to more diverse products presented to consumers. As far as legislation, this study looked into whether or not cultural industries, in this particular instance, independent music labels, deserved special treatment by competition law and it found that small businesses in cultural industries should indeed have such special consideration. The problematic issue that arises in this respect is that lawmakers often do not like to deal with difficult-to-measure concepts like cultural diversity. However, not taking cultural issues into account resulted in the fact that competition law (merger regulation in particular) has failed to protect cultural diversity so far. The concluding remarks at the end of this work will provide some concrete suggestions as to how this difficulty can be overcome. The findings of the SonyBMG wrangling below will also prove that the economical parameters of the

record industry are important, but the decision makers should not neglect the importance and protection of cultural diversity, as specified in Chapters 1 and 3.

Developing and New Jurisprudence: A New Cultural Test

The analysis of a number of mergers in the record industry exposed the decision making process' unpredictability. Both the interpretation and the application of competition law, in terms of cultural industries, need to become more consistent and coherent.

The Sony/BMG merger case study identified that in the course of protecting the independents, competition law should also consider and protect cultural diversity, thus ultimately protecting consumers. As stated in Chapter 1, one of the chief objectives of competition law, along with the balancing of competitive dynamics in a given market, is the protection of consumer interests. Therefore, the considerations do not just concern themselves with the balance of power between majors and independents, but also about the interests of a third party - the consumers. The same analysis can be drawn from the case study of resale price maintenance in book publishing and selling, i.e. that competition law should not only be about the protection of publishers and distributors of books, but also about the protection of consumer interests. Chapter 5 describes that when Warner and Polygram attempted to merge their entities, the US Court of Appeals used the public interest argument in disallowing the joint venture; however, this argument was not utilised in any other cases involving the record industry.⁹²⁶ Going back to the main objective of competition law - the protection of competition, not the competitors - the question has to be asked as to how a market share ratio of 3:1 can be considered a good competitive balance? Bearing in mind the huge gap between the bargaining and financial powers of the two types of record companies, can independents offer *effective* competition in the marketplace? It should be remembered that both the US and European competition authorities set out in their rulings that independents could exert only a *limited* pressure on the majors.⁹²⁷ Therefore, the competition authorities themselves acknowledged the lack of competition in the recorded music market. This research has demonstrated that using only economic data analyses to investigate and consider mergers was not enough to prevent high record industry concentration.

⁹²⁶ The Commission also mentioned 'consumer choice' in the EMI/Time Warner attempt to merge in 2000. However, as stated in Chapter 5, the parties withdrew their merger proposal.

⁹²⁷ Case No COMP/M.3333 - *Sony/BMG*, supra, n. 460, at para 145 and Case COMP/M. 1852 - *EMI/Time Warner*, supra, n. 694.

Consequently, the principal conclusion of this study is that there should be new jurisprudence in relation to mergers and acquisitions in cultural industries, and this is dealt with below.

Chapter 1 indicates that despite constant emphasis by national governments, the EU and UNESCO of the importance of cultural industries and cultural diversity, the latter is not a stated aim of the existing competition legislation. In contrast, however, there has been a glimmer of hope in the second approval by the Commission of the Sony/BMG merger when it, for the first time in the European merging history of the record industry, considered the ever-crucial non-price issues (discussed in Chapter 5). However, the legal position is still unsatisfactory because the existing law, including the new ECMR and Article 81 of the EC Treaty, makes no references to cultural issues. Therefore, the mention of cultural matters in the approval of the Sony/BMG merger is the extension of principle *without* the law actually saying that it would take cultural issues into consideration.

This part finalises the argument as to why the law should provide a different regime for cultural industries. To begin with, the important issue of non-price or non-economics competition has to be re-emphasised in order to see why this form of competition is so important. The issue is followed by suggestions to modify the existing competition law to take diversity of products and producers into account.

Price Competition, Non-Price Competition, and Cultural Diversity

Having considered all three rulings on Sony/BMG in Chapter 5, the section concludes that the EU competition authorities should consider culture and cultural issues. Before highlighting the importance of non-price competition, it should be re-iterated that the previous chapters criticised the Commission's approach to the application of the *law as it stands*. The following part exemplifies why the existing merger test should be modified in order to take cultural issues into account.

The study demonstrated, particularly in Chapters 4, 5 and 6, that competition takes place on many levels with price being *only one* of the competitive factors. Stigler reached the same conclusion in *A Theory of Oligopoly*, which emphasised that 'price' alone should not be the only issue considered when looking at collusion between large

companies.⁹²⁸ Other forms of competition include quality, output, and diversity⁹²⁹ (in this chapter, the meaning of diversity is the same as that given in Chapter 1, namely the diversity of producers and products). The backdrop of the price factor in record industry competition is that it certainly affects the cost of both the CDs and downloads and these price issues have to be investigated. However, as mentioned in previous chapters, there are *other* important aspects of the record industry which are *non-price* or *non-economics* related, e.g. shelf space at retailers, radio play, TV broadcasts, etc.⁹³⁰

As argued in Chapter 1, culture is a qualitative concept, and it should be protected for its cultural merits. Therefore, this study has argued that with respect to the record industry it is the diversity of products and producers that should be considered as, if not the main, then an additional important form of competition. In order to show the need for change, the analysis below summarises how, if at all, competition authorities have treated diversity in the three Sony/BMG merger rulings, and how or whether the law can be changed to accommodate cultural diversity.

Chapter 3, in covering the historical growth and competition patterns of the record industry, showed how independent music labels have predominantly been responsible for discovering new genres and artists. The majors primarily focus on ‘superstars’; hence they have less incentive to invest in the discovery and development of innovative or non-mainstream music and artists. In parallel, Chapter 1 provided that the majority of empirical studies showed an inverse relationship between the level of concentration and diversity in the record industry.⁹³¹ Bearing in mind that the four majors are now responsible for about 75 percent of the recorded music market share and those four companies increasingly cut their rosters, both the Commission and the CFI could have looked into that particular area, e.g. if an artist is rejected by the four majors, he or she would be very likely at an impasse as far as their career development. In this respect independents do play a crucial role because they give artists the opportunity to set up their own label or release their music on another independent label. Such a course of

⁹²⁸ Stigler, *supra*, n. 748, at p. 44.

⁹²⁹ Boyce and Creswell, *supra*, n. 720, at 10.

⁹³⁰ On the importance of non-price competition in the record industry see Black and Greer, *supra*, n. 112; Peter Alexander, “Product Variety and Market Structure: A New Measure and a Simple Test.” *Journal of Economic Behaviour and Organisation* 32 (1997): 207 – 214; Alan Baker, “A Model of Competition and Monopoly in the Record Industry.” *Journal of Cultural Economics* 15 (1991): 29 – 54; Gander and Rieple, *supra*, n. 121, at pp. 248 – 254; and Belinfante and Johnson, *supra*, n. 368, at pp. 11 – 24.

⁹³¹ See Rothenbuhler and Dimmick, *supra*, n. 119 and Peterson and Berger, *supra*, n. 104.

action also highlights the importance of independents from both the cultural diversity and public interest points of view.

As demonstrated in Chapter 5, the legal outcomes have always been uncertain but it is unclear why the Commission decided in 2000 that the EMI/Warner attempt to merge their entities would lead to homogenous products,⁹³² whilst in 2004 and 2007 in the Sony/BMG merger, the Commission highlighted the heterogeneous nature of the products at issue. Both the Commission and the CFI overlooked the diversity of products analysis, and instead concentrated on discounts and prices analyses.

Just how economics can be out of touch with cultural industries can be demonstrated by looking into the diversity of competition. The clash between economics and cultural industries happens because the economists tend to regard "... differentiation within a product as a variant of price, when in fact price may not be a criterion that determines purchase".⁹³³ In fact, price is definitely not a reason for purchasing music. Music is bought because of an emotional and intellectual desire to listen to a particular piece or artist. Price is a unique competitive concept and it should be solely applied when the products can be substituted. As noted in Chapter 6, cultural products, e.g. music or books, are not direct substitutes; therefore, price often is simply "... an implicit average of varying idiosyncratic values across varied purchasers".⁹³⁴ Another reason for the non-importance of the price increase in relation to the record industry is because there is a tendency for records to be sold at a standard price.⁹³⁵ Even the Commission itself admitted that the prices in the record industry were standardised.⁹³⁶ Moreover, looking at price history within the industry, prices remained at more or less the same level, or even dropped, under both competitive and monopolistic regimes.⁹³⁷ For example, prices dropped at the start of the 1980s at a time when industry concentration was high.⁹³⁸ At the moment of writing, a similar situation exists. Thus, what is apparent is that high and increasing concentration has had little influence on prices but has impacted tremendously on non-price issues because the emphasis has been "... less

⁹³² Boyce and Creswell, *supra*, n. 720, at 11.

⁹³³ Peter Johnson, *Astute Competition: The Economics of Strategic Diversity* (Oxford: Elsevier, 2007), 10.

⁹³⁴ *id.*

⁹³⁵ Baker, *supra*, n. 930, at p. 29 and Eric Strobl and Clive Tucker, "The Dynamics of Chart Success in the UK Pre-Recorded Popular Music Industry." *Journal of Cultural Economics* 24 (2000): 116.

⁹³⁶ Case No COMP/M.3333 – *Sony/BMG*, *supra*, n. 315, at para 110.

⁹³⁷ Baker, *supra*, n. 930, at p. 49.

⁹³⁸ Belinfante and Johnson, *supra*, n. 368, at p.23.

price-oriented and more product differentiation oriented”.⁹³⁹ If, as shown in Chapters 3 and 4, such non-price or non-economics issues such as A&R activities, radio, TV and physical retailers are crucially important for the record industry, they should also be taken on board in merger and acquisition investigations by the Commission and other competition authorities.⁹⁴⁰

The Commission’s reasoning in Sony/BMG, focusing only on price competition, was even more surprising in the light of its own comment in the ThornEMI/Virgin acquisition, which showed that *diversity* is the most *crucial* factor that should have been taken into account:

“The *main parameters* for competition in the market(s) for record music are the *promotion of records* and the provision of a wide *variety of artists and types of music*. Because of the special nature of the products in this market(s), the *scope for price competition* seems to be *limited*. Other parameters have, therefore, become important such as promotion through advertising, radio airplay, exposure in the media, concert tours and other promotional items. In addition, record companies can compete for access to window space and point-of-sale advertising in retail outlets. The *most significant parameter* of competition in the market for recorded music is the need to meet the demand for constant changes in music tastes and fashion, through *new releases and signing up new artists*” (emphasis added).⁹⁴¹

Moreover, in the Statement of Objections in the EMI/Time Warner case, the Commission talked about the impact the merger would have on “... consumer choice as well as the marginalisation of independents and overall impact on the diversity of music being offered to the public”.⁹⁴² It is unclear why the Commission did not pay more attention to its own words in the ThornEMI/Virgin case when considering other cases, including the Sony/BMG merger.

The fact that the first Sony/BMG decision was annulled just on economic evidence and administrative mistakes is of huge importance. In this particular case economic evidence, which was used instead of any other criteria, was enough to annul the Commission’s decision but as some would argue the CFI’s ruling was “... one-sided without a comparable treatment of the cultural issues”.⁹⁴³ The Competition Department

⁹³⁹ *id.*

⁹⁴⁰ *id.*, at p. 12 and Gander and Rieple, *supra*, n. 121, at p. 250.

⁹⁴¹ Case No IV/M.202 – *Thorn EMI / Virgin Music*, *supra*, n. 451, at para 38.

⁹⁴² *European Competition Commission*, “Commission Opens Full Investigation into Time Warner/EMI Merger.” June 14, 2000.

⁹⁴³ Aigner *et al.*, *supra*, n. 742, at p. 26.

within the Directorate General at the Commission used 6 economists to produce over 100,000 pages of economic findings with respect to the original Sony/BMG merger investigation.⁹⁴⁴ The aforesaid shows that taking into account economic data only, in terms of cultural industries, does not suffice and thus lends credence to the fact that the competition authorities, in addition to detailed economic analysis, should also use the sophisticated analysis of non-price competition issues.

Such attention being focussed on economic data seems even more bizarre as there is recognition that “product diversity *is* a key performance measure, as greater diversity is enhancing consumer welfare by increasing the likelihood that products meet heterogeneous preferences”.⁹⁴⁵ In other words, consumer interests were diminished due to cultural products being more homogenous as a direct result of higher record industry consolidation. It is worth re-iterating that the Commission, in both the first decision and its subsequent re-approval, simply relied on the submissions of Sony and BMG that their content was heterogeneous, even though acknowledging in the same decision, that *the lack of innovative products and artists* were one of the reasons for declining demand in the record industry.⁹⁴⁶ The Commission in the first decision did not even attempt to carry out an economic analysis of the effects of the merger on *non-price* competition. Whilst the CFI has made the right decision to annul the merger, the fact that there was *no* mention of the importance of independents and only two mentions of cultural diversity, is an obvious drawback. In its appeal to the Sony/BMG decision, Impala claimed that the Commission had not even enquired whether the proposed concentration would reduce supply in terms of numbers of new titles or in terms of originality of new releases, or whether it would impoverish creativity, quality and diversity in music choice.⁹⁴⁷ However, as explained in Chapter 5, perhaps due to the difficulty in succeeding on diversity as a *legal* argument, Impala did not emphasise the importance of content heterogeneity.

The CFI touched only briefly upon product homogeneity⁹⁴⁸ by highlighting the contradiction between the heterogeneity of content and the uniformity of pricing. However, the CFI did not go any further into considering this contradiction. The

⁹⁴⁴ Michael G. Egg *et al.*, “The New Merger Regulation: Recipe for Profound Change or More of the Same?” IBA 8 Annual Competition Conference (Fiesole: 17 – 18 September 2004), at p. 20, footnote 66.

⁹⁴⁵ Aigner *et al.*, *supra*, n. 742, at p. 26.

⁹⁴⁶ Case No COMP/M.3333 – Sony/BMG, *supra*, n. 315, at para 58.

⁹⁴⁷ Case T464/04 - Impala v. Commission, *supra*, n. 459, at para 107.

⁹⁴⁸ *id.*, at paras 460-462.

Commission undoubtedly made a number of gross blunders, which have been picked up by the CFI and the merger decision failed on those grounds. However, the first two rulings barely touched upon the notion of cultural diversity. Eventually, the Commission re-investigated the merger in 2007 by carrying out a complex analysis of the record industry, including reference to cultural issues and non-price items but nonetheless it was working from the current merger regulation (using the old merger test because the merger was announced before 1 May 2004), which does not provide for cultural matters at all. Moreover, the extent and the depth of the investigation into the non-price factors are disappointing. Since the law has not changed, it raises the question as to how and why the Commission extended the old substantive test and decided to look into cultural matters in the second approval of the Sony/BMG merger. The Sony/BMG saga has exposed firstly, how unpredictable the interpretation of the existing law can be, and secondly, that arguably neither the test in *Airtours*, nor the new ECMR are equipped to deal with the record industry (suggestions as to how to re-focus the merger test are detailed below).

A New Cultural Test

The arguments above illustrate that the current competition law cannot adequately regulate the record industry (as part of cultural industries) nor protect cultural diversity. That is not to say that law is the wrong mechanism, but it does need re-focusing. It seems that current competition legislation is fit to regulate the aerospace, commodities', and oil industries, but arguably, one cannot apply the same rules to regulating both manufacturing *and* cultural industries. Even the introduction of the new ECMR (which is yet to be applied in record industry mergers) seems unlikely to change the current state of affairs in the music business.

It is possible to assess hypothetically whether the substantive test of the new ECMR, which does not necessarily require the creation or strengthening of a collective dominant position but merely that competition is significantly impeded by the merger, is likely to deal more effectively with the oligopoly problem in the record industry. Firstly, post *Airtours* it will be very difficult for the Commission to establish that non-collusive coordination will be likely after the merger when it was not likely before. Secondly, and more importantly, as has been demonstrated in Chapter 5, significant

impeding of any effective competition can be achieved by much smaller acquisitions that do not require any notification to the Commission.⁹⁴⁹ Thirdly, it is debatable how any new test, notwithstanding any future mergers being disallowed, will dilute the high concentration of the record industry.⁹⁵⁰ Whilst technological advances and new players coming from outside the record industry, such as telecom and mobile companies, may erode the majors' high concentration, erosion of the majors' power is yet to be seen. Re-wording the old ECMR test into a new one alone is unlikely to solve the record industry's concentration problem. Fourthly, the pre and post analysis that the CFI set out in *Airtours* will still have to be carried out.⁹⁵¹ The new test will require that impediment to competition is increased by a merger, and that the impediment was unlikely to take place before. This is not going to be an easy task. In addition, the interpretation of the new test will depend on the Commission's interpretation and as seen in Chapter 5, it may be quite wide and ambiguous.

Post CFI ruling, Sony/BMG appealed to the ECJ against the judgment of the CFI on points of law, followed by a virtually simultaneous interrogation of the Commissioner by the European Parliament as to the impact of the Sony/BMG merger on SMEs and cultural diversity.

In December 2007, the ECJ released the lengthy opinion of the Advocate General, Juliane Kokott, who stated that the merger should be *disallowed* on the points of law.⁹⁵² No cultural issues were ever discussed in her decision, but she clearly confirmed that the CFI was correct in its legal assessment. Although the opinion of the Advocate General is not binding for the ECJ, according to the statistics, the ECJ follows his or her opinion in the majority of cases.⁹⁵³ The Sony/BMG case turned out to be a rare exception as on the 10 July 2008, the ECJ annulled the CFI's judgment stating that the CFI assessed only two out of the five Impala pleas, therefore the CFI was ordered to re-assess its judgment.⁹⁵⁴ However, there was another unexpected development in that on 5 August 2008 (right at the end of this research) BMG sold back 50 percent of its stake

⁹⁴⁹ Hornsby, *supra*, n. 679.

⁹⁵⁰ *id.*

⁹⁵¹ *id.*

⁹⁵² *European Court of Justice*, "Opinion of Advocate General Kokott on Bertelsmann AG and Sony Corporation of America." December 13, 2007. See also Lars Brandle, "SonyBMG Ruling Scrutinised in EU Court Opinion," *The Billboard*, December 13, 2007.

⁹⁵³ Frances Murphy and Gillian Sproul, "SonyBMG Joint Venture Saga – ECJ Hits CFI One More Time." *Mayer Brown*, July 14 2008.

⁹⁵⁴ C-413/06 P - *Bertelsmann and Sony Corporation of America v. Impala*, [2008] OJ C223/7.

in SonyBMG to Sony for £900 million (although BMG will retain music rights management for its top 200 artists).⁹⁵⁵ The Commission considered the acquisition under the new Merger Regulation (Council Regulation No 139/2004),⁹⁵⁶ however it did not apply the new SIEC test. It is safe to say that having approved the Sony/BMG merger in 2007, the Commission would approve the acquisition by Sony of BMG because “... a change from joint to sole control only has a limited impact on the competitive structure.... as the acquiring undertaking already exercised control”.⁹⁵⁷ The CEO of Sony, Howard Stringer, noted that the transaction would provide “... a deeper integration between the music company and Sony’s consumer electronics products”.⁹⁵⁸ Curiously, there was no mention of cultural diversity. This time the Commission had no problem clearing the acquisition in the light of the vertical integration between Sony’s hardware and music businesses.⁹⁵⁹ The final ‘cap’ on the SonyBMG saga was put by the CFI itself in 2009, when it held that there was no need to adjudicate any further on this merger case and that any future action would be devoid of purpose.⁹⁶⁰

Back to 2007, in parallel with the ECJ’s investigation, the European Parliament, launched an enquiry as to how the Commission could clear the merger when the record industry was already so concentrated, and what impact that merger could have on the SMEs in the cultural sector and cultural diversity overall (for more on this see Chapter 4). Therefore, the EP re-confirmed that *non-economics* based issues should be taken into account. As expressed by Guy Bono:

⁹⁵⁵ Case No COMP/M.5272 - *Sony/SonyBMG* [2008] OJ C 259; Ron Grover, “Sony Buys the Rest of Ailing SonyBMG,” *The Business Week*, August 05, 2008; Andre Paine, “Bertelsmann Exits Sony BMG,” *The Billboard*, August 05, 2008; Gerrit Wiesmann and Andrew Edgecliffe-Johnson, “Sony Agrees to Buy Out Bertelsmann,” *The Financial Times*, August 05, 2008.

⁹⁵⁶ In approving the deal, the Commission made a following proviso: “the present decision is based on the premise that the Sony/BMG merger has been authorised; should the pending litigations lead to a different outcome which would require to dissolve the Sony/BMG concentration or take other restorative measures, the present decision cannot be read as an obstacle to full compliance with such an obligation.” Case No COMP/M.5272-*Sony/SonyBMG*, supra, n. 955, at footnote 3.

⁹⁵⁷ The acquisition was said not to have any negative impact on consumers and cultural diversity. *id.*, at paras 49, 100, 101, 108.

⁹⁵⁸ Grover, supra, n. 955.

⁹⁵⁹ Paine, supra, n. 955.

⁹⁶⁰ Order of the Court of First Instance (First Chamber) 30 June 2009. Para 30 of the Order provides the following reasons as to why Impala decided to stop any further proceedings: “In that regard, the applicant [Impala] states that it did not bring proceedings to challenge the third decision [the acquisition by Sony of BMG], because the Court would have been required to adjudicate on the present case and on Case T-229/08 before examining the third decision. By the time those actions had been decided, Bertelsmann would have been absent from the market for recorded music for many years. Furthermore, even if the three actions had been successful, Bertelsmann could not have been compelled to return to the market, so as to restore the competitive situation prevailing prior to the contested decision, that is to say, the presence of five major record companies”.

“The Commission once again has side stepped the issue. There is a paradox existing between the policy of support for SMEs and the second Commission approval of the Sony/BMG merger. As underlined in my report, concentration in the sector of cultural industries constitutes a risk for the diversity and the offer of cultural goods to consumers. There is a need for further support for SMEs and micro businesses who contribute hugely to creating wealth in an economy whose growth does not necessarily require the existence of large-scale organisations....”⁹⁶¹

In particular, the EP’s main criticism of the approval of the Sony/BMG merger was based on the grounds that the Commission disregarded:⁹⁶²

1. The European Council’s paper as of the 8 May 2007, which confirmed “the importance of SMEs in the cultural sector in view of their role as drivers of growth, job creation, and innovation”.
2. The UNESCO Convention that emphasised that “cultural diversity is manifested through the varied ways of artistic creation and production”.
3. The Commission’s communication on a European agenda for culture in a globalised world.
4. Previous cases in which the European Commission “re-iterated the necessity of introducing remedies to re-establish a competitive recorded music market, e.g. the EMI/Warner attempted merger in 2000, and the Universal/BMG decision in 2007”.

The EP’s criticism seems correct, but it also can be considered *unfair* to the Commission because the latter does not have a merger test that could take cultural issues into account. The merger test, as shown above, is silent on the issue of cultural matters and this situation has to be remedied. Perhaps this is why in another enquiry into the SonyBMG merger in 2008, the EP asked the Commission whether it would

⁹⁶¹ Quoting Guy Bono in *Impala*, “European Parliament Challenges Commissioner Kroes Again on SonyBMG.” December 20, 2007. See also Lars Brandle, “European MP Questions SonyBMG Merger,” *The Billboard*, October 30, 2007.

⁹⁶² These grounds are also cited in *Impala*, id.

consider adopting *specific* new competition law rules and guidelines which afforded taking cultural concerns into account.⁹⁶³

One of the main conclusions of this thesis is that competition authorities have failed to prevent high record industry concentration. Although the EU policy makers often use the expression ‘cultural diversity’, not much has been done in reality to protect and promote the notion of cultural diversity: “in fact, this general ‘*amnesia*’ appears to be a permanent feature of the Commission’s approach to the audiovisual market”.⁹⁶⁴ Arguably, it happened because neither the past nor existing test contain any provisions to take into account the issue of cultural diversity. The main issue that arises in this respect is that competition law influences cultural industries, but it contains no legal tool to regulate them. Since there has been an increased wave of mergers and acquisitions in cultural industries, particularly recently, it would make more sense for the Commission to consider the impact of such mergers on cultural diversity.

The new wave of opposition⁹⁶⁵ to using only econometric analysis is a ray of light in the current legal system, but ultimately, the old or new ECMR tests do not contain a requirement to take culture and cultural diversity on board when investigating mergers and acquisitions in the record industry. That explains why neither the Commission in its first decision, nor the CFI in its judgment ventured into the area of cultural diversity, and it is not clear on which basis the Commission did so in the second approval. Thus representing the dilemma threaded throughout this study; that on the one hand both the EU and national authorities emphasise the importance of culture and SMEs, but on the other hand they make no provision for either in the current competition legislation. This begs the ultimate question of how can competition law protect the heterogeneity of both products and producers in cultural industries? The answer depends on whether or not culture and cultural diversity represent a competition concern. Using culture as a non-competition concern would be easier for the lawyers. Therefore, the law has to accommodate culture via the inclusion of non-price competition and specifically mentioning culture. The latter is bound to produce a debate among scholars and

⁹⁶³ *Impala*, “European Parliament Challenges the Commission Again about Competition in the Music Market and the SonyBMG Merger, as Independents’ Appeal Continues without New Action over Sony Buy Out.” December 19, 2008.

⁹⁶⁴ Herold, *supra*, n. 884, at p. 11.

⁹⁶⁵ See for example, Monica Arino, “Competition Law and Pluralism in European Digital Broadcasting: Addressing the Gaps.” *Communications & Strategies* 54 (2004): 97 – 128.

practitioners, but without this reference, lawyers will still have no adequate tool to assess the competitive dynamics in cultural industries.

This study suggests two solutions in relation to the new jurisprudence:

1) *Changing* the new ECMR to include *specific* reference to non-price competition and culture. This test could be applicable to any economic activity to which the ECMR applies, if it has a cultural dimension. The inclusion of non-price issues would make it easier for lawyers to apply this test. Such an approach should position the Commission to be free to draw from cultural concerns. Another advantage of such modification is that it would be easier to exercise a balancing act between the economic and non-price data analyses, and therefore, easier to apply this test in practice.

2) *Displacing* the new ECMR in order to create a new regime and a new system for cultural issues. The main problem with this approach would be providing legal definitions of cultural issues, e.g. culture and diversity. Whilst Chapter 1 illustrated that it is possible to define both culture and diversity, e.g. strip down the definition of cultural industries to bare basics, such as the record and book industries, it is one thing to provide a definition by a scholar, and quite another thing to make these categories measurable and definable by law. The lawmakers may find it difficult to apply such a test, and it would be as uncertain as the current econometric analysis.

Thus, the advantages of the first proposition make it more appealing, and this represents the main finding of this study.

New competition rules to recognise the specificity of culture have already been suggested by the Impala in its Action Plan,⁹⁶⁶ appearing to be a timely step forward. However, even Impala realises that cultural diversity being introduced into competition regulation is a difficult task, perhaps explaining why Impala also introduced a new term, ‘economic diversity in music’. Meaning that the independents produce about 80 percent of all music released in Europe, thus creating vast employment opportunities. The introduction of economic diversity to a certain extent blurs the importance of cultural diversity on its own, but the upside of it is that the economic potential of culture maybe

⁹⁶⁶ *Impala*, “Action Plan for Music in Europe: Boosting the European Cultural Economy by Reinforcing SME Actors in Music.” March 13, 2008.

easier assessed by the regulators. In the end of 2008, Impala also opened another dialogue with Jan Figel, European Commissioner for Culture, which subsequently launched a Green Paper on Cultural Industries.⁹⁶⁷ The paper will examine the anti-competitive practices experienced by independents in the digital age, e.g. entry barriers to mobile and online markets.

Article 81 of the EC Treaty

Additionally to the ECMR, the analysis of Article 81 of the EC Treaty in Chapter 6 illustrated that the Commission is not *equipped* with any actual instrument to promote cultural diversity under Article 81. Also, similarly to the ECMR, the introduction of the economic analysis to Article 81 disregards the non-competition matters, which are nevertheless important for culture and the consumers.

As demonstrated in Chapter 6, the EC Treaty contains somewhat of a contradiction between the aims of the European Union to protect competition under Article 2 of the EC Treaty, and to preserve culture under Article 151(4). Both are the constitutional tasks of the EC Treaty. The conflict between the constitutional objectives, i.e. to protect competition and to protect *other goals* of the Community is indeed not an easy one to solve. As shown in Chapter 1, there are profound tensions between art and commerce, which are projected into the EU goals to protect competition and culture at the same time. These tensions represent the main dilemma. On the one hand, the economic approach that the Commission takes, disregards non-economic factors thus avoiding any national government's political influences. On the other hand, the Treaty contains an express obligation to take *other goals* of the Community into account; therefore, a political interpretation of competition policy is indeed imposed.⁹⁶⁸ Apart from not providing the Commission with any concrete instruments and guidelines as to how the law should preserve culture, there is no hierarchy between the two objectives.⁹⁶⁹ However, that is not to say that competitiveness of the record industry cannot be improved while taking into account its cultural dimension.

⁹⁶⁷ At the moment of submission, the Green Paper is not yet published. *Impala*, "Impala Meets EC Commissioner Figel in Cannes – Discrimination of Independents to be Examined in EC's Cultural Industries' Green Paper." January 19, 2003.

⁹⁶⁸ Monti, *supra*, n. 868, at p. 189.

⁹⁶⁹ Herold, *supra*, n. 884, at p. 14.

As exemplified in Chapter 6, the Commission has on occasion exercised a margin of discretion as to *other goals* when applying Article 81(3). Additionally, the ECJ has upheld some of the Commission's decisions, which involved the assessment of non-competition issues.⁹⁷⁰ Having said that, such sporadic decision-making, without a specific legal tool, is not enough to preserve the interests of culture.

The clash between competition law provisions under Article 81 and culture needs to be resolved now as according to the *White Paper*, the *national* competition authorities and courts in future will decide on the cases under Article 81(3).⁹⁷¹ Importantly, as indicated in Chapter 6, the *White Paper* suggested a narrower and more legalistic interpretation of Article 81(3).⁹⁷² Enabling national courts and authorities to grant exemptions under Article 81(3) has the potential to open a Pandora's box for all kinds of conflicts. Firstly, introducing non-competition issues into the EC Treaty means that they should be taken note of only when considering Community goals, not national ones.⁹⁷³ This is clearly stated in Article 151(4) which refers to the other *Community* policies and activities. Thus, it seems that even though national courts will be able to decide on the exemptions under Article 81(3), they would not be able to protect diversity on their own territories. Secondly, national courts may not wish to limit themselves to a narrow reading of Article 81(3) and this scenario has to be borne in mind because it may cause a vertical conflict, a conflict between national and Community competition law, as well as a diagonal conflict meaning an unease between EU competition law and Member States' other laws.⁹⁷⁴ The latter can be exemplified by Germany asking the Commission to take cultural policy into account when deciding whether to remove price-fixing for German language books.⁹⁷⁵ Moreover, national authorities may not be in a position to "balance the restriction of competition that an agreement might entail against a broad range of Community policies".⁹⁷⁶ This, in turn, might result in a narrow interpretation of the Article 81(3).

In the past, the ECJ noted that it was not itself capable of assessing the economic facts in terms of considering exemptions under Article 81(3). Instead, the ECJ commented

⁹⁷⁰ For more details see Wesseling, *supra*, n. 882, at p. 424.

⁹⁷¹ *The White Paper on Modernisation*, *supra*, n. 864, at paras 58 – 62.

⁹⁷² *id.*, at para 57.

⁹⁷³ Prior to the creation of the EU, national courts dealt with these issues. After the creation of the EU, competition law held sway over national law. See also Komninos, *supra*, n. 873, at p. 6.

⁹⁷⁴ For more details see Wesseling, *supra*, n. 882, at p. 425.

⁹⁷⁵ See the example in Whish, *supra*, n. 863, at p. 129, footnote 13.

⁹⁷⁶ *id.*, at p. 128.

that the Commission was the appropriate body to exercise the balancing act between the protection of competition and other goals.⁹⁷⁷ This raises another concern as to the consistency in the application of the European competition law by different Member States,⁹⁷⁸ i.e. it is not clear how the numerous national courts with *different legal regimes* will interpret and apply the provisions of Article 81(3). The Commission will provide guidelines but it will necessarily leave the final interpretation to national courts.⁹⁷⁹ Bearing in mind that the ECJ said of itself that it was not equipped to carry out complex economic analyses, national authorities too would have an even more difficult task balancing competition protection with other Community aspirations.⁹⁸⁰ Therefore, the measures suggested by the *White Paper* are unlikely to resolve the conflict between competition law and non-economic considerations.

Before listing suggestions as to how to incorporate cultural issues into Article 81, it is worth highlighting differences between the ECMR and Article 81. The ECMR represents a more holistic approach, whereas Article 81 (3) is about positive (hard) law because it has only four exceptions and all of them require solid evidence. In terms of pragmatics, it is much easier for a decision-maker when deciding on the validity of a merger or an acquisition to take cultural issues on board. In addition to the above suggestions as to how to amend current ECMR, the judges can always look into cultural diversity under Article 151 and it could be dealt with as a rule of reason type of approach, i.e. looking at the merger holistically, including both economic and non-economic factors. The cultural issue can also be placed in the ECMR amongst other economic factors or *pari passu*, i.e. both price and non-price factors could be treated equally. Thus, the ECMR could give the decision-makers liberties, which hard law cannot provide, because it is a holistic test and it fits into the argument of this thesis. On the contrary, Article 81 was drawn in a positive way; it is interpreted stringently, and because of that there maybe a problem of *how* to incorporate the cultural diversity issue into Article 81. In terms of pragmatics, it is much harder to produce evidence to show that there could be more cultural diversity, had a certain practice been allowed to go on. The biggest problem in this respect is that cultural diversity is not a measurable goal. However, that is not to say that cultural diversity is not a worthwhile objective. The cultural diversity exemption could be brought up under Article 81(3), however this

⁹⁷⁷ See for example, Cases 56 and 58/64 *Consten and Grundig v. Commission* [1966] ECR 341.

⁹⁷⁸ For more details see Wesseling, *supra*, n. 882, at p 424.

⁹⁷⁹ Schmid, *supra*, n. 871, at p. 169.

⁹⁸⁰ Wesseling, *supra*, n. 882, at pp. 424-5.

thesis recognises that it will cause some problems (discussed below) and they will not be easily solved.

Unfortunately, to date there is no jurisprudence in terms of protecting diversity of music under Article 81 (3). The case study of book price-fixing has demonstrated the tension between the law and culture and highlighted the fact that the Commission was not ready to give priority to cultural values over competition law. The book price-fixing case study affords drawing the following analogies and lessons in terms of the record industry. By making the analogy with book publishers and booksellers, it could be argued that the protection of independent music labels leads to cultural diversity, with resulting benefits to consumers and society. The latter was one of the arguments in the book price-fixing debate. Therefore, it seems that Article 81(3) could potentially be used to protect cultural diversity in the record industry but only via the prism of consumer interest protection. The aforementioned begs the question of what could be done to improve this situation?

Scholars provided various suggestions as to the location of cultural exception in Article 81. These suggestions can be classified into two groups: hard law and soft law.

The first group is self-explanatory in that it accumulates the opinions that non-economic concerns should be *outside* the scope of Article 81 (3). Chapter 6 summarised the rationales for the hard law approach, i.e. that the incorporation of hard-to-measure cultural issues would make the analysis more difficult.

However, this study has shown that cultural diversity could or should be admitted into the analysis under Article 81(3). Therefore, begging the soft law approach, meaning that law should consider cultural diversity. The question that arises in this respect is how cultural diversity should be treated under Article 81? The answer once again depends on whether one treats cultural diversity as a competition concern or a non-competition concern? Akin to the ECMR, treating cultural diversity as a competition concern is possible but more problematic. Treating cultural diversity as a non-competition concern is less debatable and easier to apply in practice.

Starting from the latter option, there are a number of alternatives within it. The first approach would be the introduction of achieving a balance between both the pro and

anti-competitive constituents of the economic issues of the agreements under Article 81(1). This is argued to enable Article 81(3) to take on board *other goals* of the Community.⁹⁸¹ According to this approach, if the pro-competitive aspects prevail, the agreement does not fall under Article 81(1); therefore, there is no need to consider the exemptions under Article 81(3). Thus, only if anti-competitive effects outstripped pro competitive effects would recourse to Article 81(3) be required. Such an approach however, would re-introduce the debate about the rule of reason.⁹⁸²

Some scholars insist that the Commission could legitimately consider non-economic considerations under Article 81(3), in particular cultural issues, had there been a teleological (when an action is morally justified by the outcome, or the ends do justify the means) interpretation of the EC Treaty competition provisions.⁹⁸³ In other words: “... competition can be sacrificed when the social costs of it might be too high”.⁹⁸⁴ As demonstrated in Chapter 6, such reading of the Treaty competition rules has already taken place in a number of rulings by the Commission and the ECJ.

However, it seems that the best option suggested with respect to Article 81(3) could be to balance the *provisions* of Article 81(3), *as a whole*, against the other constitutional goals of the Community without including them in the substance of Article 81(3).⁹⁸⁵ The rationale for this approach is that the priority still lies with Article 81(3), however, the Commission would have to be aware of the non-economic issues but not to the extent that they should drive though the decision-making process. Thus, non-economic concerns would only form a backdrop in decision making. Such an alternative considers non-economic issues only as a matter of conciseness, or at arm’s length. This solution seems to be less controversial as well as the easiest one to implement, as it does not change the wording of Article 81(3). The unease that I have with this solution is that it seems *incomplete* to take culture into account only “as a further positive element among other economic efficiency elements of a restrictive agreement”.⁹⁸⁶ This is not to

⁹⁸¹ *id.*, at pp. 422-3; and Ehlermann, *id.*, n. 879, at p. 548.

⁹⁸² Wesseling, *id.*

⁹⁸³ Mario Siragusa, “Comment” in *European Competition Law Annual 1997: The Objectives of Competition Policy*, ed. Claus Dieter Ehlermann and Laraine Laudati (Oxford: Hart Publishing, 1998), 549, footnote 20; Wulf-Henning Roth, “Strategic Competition Policy: A Comment on EU Competition Policy,” in *The Evolution of European Competition Law: Whose Regulation, Which Competition?* ed. Hanns Ullrich (Cheltenham: Edward Elgar, 2006), 40

⁹⁸⁴ Motta, *supra*, n. 671, at p. 15.

⁹⁸⁵ Komninos, *supra*, n. 873, at pp. 9-10.

⁹⁸⁶ *id.*, at p. 6.

say that the approach is poor, but it still leaves the Commission with *no* specific legal tool to protect culture and therefore, in a way, goes against one of the main findings of this thesis, i.e. that culture is a legitimate (and constitutional) value that needs to be taken into account when balancing competition in, for example, the record industry. That perhaps explains why some voices went as far as suggesting re-writing Article 81(3) to specifically include and emphasise non-competition considerations.⁹⁸⁷

Therefore, another solution is to treat cultural diversity as a non-competition concern, but to include it within Article 81(3). In that case cultural diversity would clearly be taken into account under the assessment of competition law. The aforementioned suggestion would be bound to produce a huge debate amongst competition lawyers, but without the *express* legal tool in the EC Treaty, perhaps a special exemption based on cultural values,⁹⁸⁸ Article 81 is unlikely to be able to protect both culture and cultural diversity. Therefore, what is needed is an explicit definition of competencies of the Commission in terms of how to protect diversity in cultural industries under Article 81(3). It does not mean that Article 151(4) should take precedence over other EC Treaty objectives, e.g. protection of competition, but one could argue that “... the goals identified under the various EU policy headings must be attained in the most-culturally friendly way”.⁹⁸⁹

The above demonstrates that the incorporation of a cultural diversity clause into Article 81 is by no means a straightforward issue. There would be a certain number of stumbling blocks. Firstly, all current provisions of Article 81(3) are outcome-based because they are easy to measure. That is not to say that cultural diversity cannot be a factor in a decision-making process, but the problematic point is that once it is translated as a defence, it requires defendants (e.g. independent labels) to produce outcomes. Another important practical point is that with Article 81(3) the burden will lie on the independents to prove that a particular agreement will benefit cultural diversity. As indicated in Chapter 3, independents are likely to have a small turnover, and as a result, limited financial resources to defend their action. Therefore, even though they may have defence under Article 81(3), it could prove to be on paper only.

⁹⁸⁷ Christian Kirchner, “Comment,” in *European Competition Law Annual 1997: The Objectives of Competition Policy*, ed. Claus Dieter Ehlermann and Laraine Laudati (Oxford: Hart Publishing, 1998), 515, 517.

⁹⁸⁸ Schmid, *supra*, n. 871, at p. 167.

⁹⁸⁹ Psychigiopoulou, *supra*, n. 731, at p. 838.

The above may be only teething problems that could be overcome as the jurisprudence develops, but they have to be acknowledged in this research.

Finally, a completely different (and easier) solution to the problem is to incorporate cultural diversity into Article 81(3) as a rhetorical service or a formalistic recognition of cultural diversity as a laudable outcome. In this sense the law recognises the role it has with regard to cultural diversity and its protection. For example, free trade agreements between countries often have a clause which ensures fair competition. However, such agreements contain no definition, no enforcement procedures or dispute resolution procedures if the clause is breached. Thus, in a way such a clause does not do anything, but it serves well in international relations; it creates *opinio juris*, i.e. an action is taken because it is a legal obligation. With time, it may crystallise into something more concrete. In this case, the onus will lay with the European Commission (not the independents) to come up with a test of what the protection of cultural diversity under Article 81(3) is.

Additional Factors to Be Considered by Competition Law Authorities when Dealing with Cultural Diversity in the Record Industry

This research demonstrated that the existing legal mechanisms that were used to protect the record industry from consolidation have proved inadequate. The embrace by the Commission of empirical analysis of price effects, ignoring the diversity of competition in cultural industries, does not seem to offer much of a decent prospect. However, as demonstrated above, there is a glimmer of hope in the second approval and the challenge of the Sony/BMG merger by the European Parliament. This study has sought to illustrate that the economic analysis undertaken in the context of merger and acquisition investigations should take diversity into account, as some of the most important competitive factors in the record industry are indeed innovation and diversity. The fact that diversity levels are inversely connected with concentration levels in the record industry (discussed in Chapter 1) indicates that competition law should support cultural diversity. However, in order to do so, lawyers need an *operational* definition of ‘cultural diversity’ in relation to cultural industries as opposed to the wide definition provided by UNESCO. The research considered in Chapter 1 showed that diversity *could* be measured, but it seems too simplistic and incorrect to measure diversity based

on the top 100 hits from Billboard or similar charts; diversity means more than that. For example, the charts contain up to 100 albums, but they do not necessarily demonstrate the diversity of musical genres. Besides, the questions arise as to how one measures diversity in a digital market and what happens when independent labels have numerous deals with majors? This study suggested that diversity should incorporate two categories: diversity of products and diversity of producers. But more precise formulae of how to measure the diversity of producers and products are needed. All these arguments demonstrate the need for a thorough definition of diversity that could be used by lawyers in the digital age, and it could well be the subject matter of another thesis.

Additionally, when assessing a proposed merger, the Commission should take on board the distribution aspects as well. Traditionally, it was the *production* of cultural products, in this case records, that was of crucial importance. However, in the digital age, there is a shift in importance from production to *distribution*. Presently, it is the majors who own not only their distribution channels, but the majority of independent distributors as well. The fact that Rupert Murdoch owns the biggest platform for independent musicians, MySpace, speaks for itself.⁹⁹⁰ In this respect the creation of MySpace Music service⁹⁹¹ between MySpace and the four majors rings an alarm bell as the new service is jointly owned by the News Corporation and the majors, leaving no stake for the independent sector, which contributes so much to the Long Tail. Therefore, it is the *distribution* of music to which the competition authorities should pay more attention, instead of price increase issues.

Additionally, as stated above, digital technology may aid in diminishing the market power of majors. Advanced technology has already provided smaller labels with numerous opportunities to record and release new music. However, digital technology does not yet provide *effective* competition between majors and independents as one of the biggest keys to success in the record industry lies in extensive (and expensive) marketing. Moreover, in terms of the relationship between law and cultural diversity, technological advances also raise a number of questions: for instance, how will competition law grasp digital technology? Another is how will competition law deal

⁹⁹⁰ BBC, "News Corp in \$580m Internet Buy," July 19, 2005.

⁹⁹¹ Andrew Orłowski, "MySpace Music Leaves Creators Cold," *The Register*, April 4, 2008; Austine Modine, "MySpace Trumpets Music Service," *The Register*, April 3, 2008.

with cultural diversity in the twenty-first century when music is being sold, and in some cases owned by players, other than record companies, e.g. mobile phone companies and telecoms? Therefore, these issues need to be taken in to account when investigating mergers and acquisitions.

The evident conclusion of this research is that competition law has failed to prevent high consolidation within the record industry, and consequently, to protect cultural diversity. However, it would be extreme to say that competition law should be made redundant, in fact, quite the opposite. There *is* a need for competition law to regulate cultural industries, as they cannot be left to self-regulation (see Chapter 1). Cultural diversity needs to be protected and the competition authorities should have specific legal rules. A crucial point of this study argues that it is important to keep competition law and theory, because particularly in horizontal merger analysis, evidence-based tests would be vital in determining possible anti-competitive effects.⁹⁹² Additionally, economic theory, backed up by empirical data, is vital for analysing possible damage to both competition and consumers.⁹⁹³ However, the most important feature of this research shows that competition authorities should pay more attention to cultural matters when considering mergers and acquisitions in cultural industries. The incorporation of the analysis of cultural matters into the investigation process would make merger analysis flexible and forward-looking. In other words, merger regulation in the twenty-first century should reflect this century's cultural industries' needs.⁹⁹⁴

Taking a futuristic approach, even if the majors become fragmented and the power shifts into the hands of telecoms and mobile phone companies, the independents (along with cultural diversity) will be in a much weaker position because they are unlikely to be able to compete at all with those powerful players. If mobile phone operators and telecoms are dwarfing the majors now, what is there to say about the independents? The effect of mobile phone operators and telecom giants using music as a loss leader must not be under-estimated. Will these conglomerates want to have eclectic or non-mainstream music or will they prefer to feature superstars on their portals and devices? One look at the front pages of the biggest Internet portals will point to the latter. Thus,

⁹⁹² Adrian Majumdar, "Whither Dominance." *European Competition Law Review* 27, no. 4 (2006): 161.

⁹⁹³ *id.*, at p. 162.

⁹⁹⁴ *BBC*, *supra*, n. 140. The importance of flexibility when dealing with cultural industries was also emphasised by DiMaggio, *supra*, n. 26, at p. 68.

the dilemma between law and culture, high concentration and cultural diversity should be dealt with now.

This research argued for the importance of cultural industries and cultural diversity to be recognised and for their special treatment by competition law. However, as specified in Section 1.10, the limitation of this study is that it has used only the record industry as a tool to prove the thesis. There are, of course, other types of cultural industries, and some of them have been mentioned throughout the study. It would be ideal to have similar research carried out into these other types of cultural industries. However, at this point it can be concluded that the findings of this research are relevant to those other types of cultural industries and therefore could be applied to other areas of cultural industries. For example, the film industry has a similar concentration issue exemplified by a small number of US film producers dominating screens around the world. At the same time, low and even high budget movies produced elsewhere do not normally even get to the big screens outside their territories. This result impairs cultural diversity, and as such should be dealt with under competition law as a non-competition concern. The book publishing and book selling industries experience similar problems, which have been touched upon in Chapters 1 and 6, namely that independent book sellers struggle to compete with big chains. In this case, price is of importance more so than in case with the record industry but such a non-price issue as cultural diversity should also be taken into account in future mergers and acquisitions by the big chains. Therefore, the modification of the existing ECMR seems to be able to bring better decision making in these other types of cultural industries, but more research is needed in this direction.

The conflict between law and culture is yet to be reconciled and perhaps future works could contribute to this dilemma. Contemporary competition is going to become even more complicated with mergers becoming more and more of transnational nature, which in turn involves the complexities of different legal regimes. Moreover, in future the record industry will become increasingly inter-connected with numerous digital channels, broadcasters, and ISPs, which in turn will make sustainable competition patterns more difficult to identify. Nevertheless, this conflict needs to be resolved, and it is the hope of this author that this and future studies will contribute to solving this issue.

Concluding Remarks: Other Ways to Diminish Concentration in the Record Industry

Apart from the ECMR this study highlighted other potential avenues for protecting cultural diversity, e.g. Article 81 of the EC Treaty (not yet exercised in relation to the record industry) and complaints to national trading authorities. Other ways to diminish the oligopolistic structure of the record industry could include further actions by competition law, e.g. forcing the sale of parts of conglomerates, and providing state support for new and innovative companies. When a proposed merger requires an in-depth analysis, the introduction of an independent appraiser might be another way forward; this already exists in the British system in the Office of Fair Trading. The American example of merger cases being dealt with in court is also worthy of consideration. However, private litigation is expensive and very few independents could afford an action against a major.⁹⁹⁵

There are of course other ways to reduce concentration levels, and to prevent further consolidation. Copyright law is the most important of them all. The interesting thing about copyrights is that there are no anti-competitive effects of copyrights as such.⁹⁹⁶ However, the fact that there is such a high concentration of copyrights held by relatively few companies does allow the majors to abuse and increase their market power and somewhat control diversity.⁹⁹⁷ Therefore, another way to prevent even further consolidation in the record industry would be by not extending the copyright term in sound recordings. As argued in Chapter 4, competition and copyright law have divergent effects because the former seeks to prevent a monopoly, whilst the latter grants monopoly rights. But it could also be argued that the objectives of the copyright and competition laws are essentially the same. Both sets of rules should seek to promote innovation and investment to the benefit of consumers. As Advocate General, Gulmann, stated in *Radio Telefís Éireann v. Commission*: “It must not be forgotten...copyright law - like other intellectual property rights - also serves to

⁹⁹⁵ Quoting Oliver Bretz, a competition lawyer of Clifford Chance in *The Economist*, “Let’s Try That Again,” July 22, 2006, at pp. 68-69. Clifford Jones, “Foundations of Competition Policy in the EU and USA: Conflict, Convergence and Beyond,” in *The Evolution of European Competition Law: Whose Regulation, Which Competition?*, ed. Hanns Ullrich (Cheltenham: Edward Elgar, 2006), 34.

⁹⁹⁶ Some argue that parallel imports constitute an anti-competitive effect of the copyright. See *Out-Law*, “CD WOW! Loses Six-year Parallel Import Battle with Music Industry,” March, 20, 2007.

⁹⁹⁷ Bishop, *supra*, n. 236, at pp. 443 – 471.

promote competition”.⁹⁹⁸ However, as shown in Chapter 4, the acquisition of copyrights was, and still is, one of the main reasons for consolidation in the record industry, with the direct consequence of cultural diversity diminution. That is why the competition authorities should consider how the consolidation of copyrights in the hands of a few majors affects cultural diversity.

As stated in Chapter 4, since 2004 there has been a trend to extend the term of copyright protection in sound recordings, which could result in reducing cultural diversity. Thankfully, the recommendation of the Gowers Review for term not to be extended in sound recordings⁹⁹⁹ shows some positive signs. However, the general reluctance of the UK government has to be counter-balanced with several attempts this time by the EU itself to increase the term of copyright protection in sound recordings from 50 to 95 years.¹⁰⁰⁰ Once again the Commission chose to ignore that copyright monopolies can stifle innovation and progression, for instance the re-release of old recordings and new music based on sampling, whilst providing a steady income stream to the majors, precisely why the record industry has spent so much time and money in lobbying governments for the extension.¹⁰⁰¹ Time will show whether national governments will resist the EU pressure. To the moment of writing, the UK government was not convinced as to an economic case for extending the copyright term for performers: “we would need to be convinced of real benefits, particularly that it is truly the performers who will benefit rather than the record labels”.¹⁰⁰²

One of the reasons why major record companies grew to their size was the advantage of copyright ownership and by having considerable market power, they are able to acquire more copyrights, which are both their most valuable asset and their largest investment at the same time. The phenomenon creates a vicious circle, discussed in greater detail in

⁹⁹⁸ Opinion of Advocate General Gulmann in joined cases C-241/91 P and C-242/91 P - *Radio Telefis Eireann and Independent Television Publications Limited v. Commission* [1995] ECR I - 00743, at footnote 10.

⁹⁹⁹ Andrew Gowers actually considered shortening the copyright term in sound recordings to less than 50 years but thought it was “politically prudent” to do so. See *Out-Law*, “Gowers Considered Cutting Music Copyright to under 50 Years.” April 26, 2007.

¹⁰⁰⁰ *Europa*, “Performing Artists – No Longer Be the Poor Cousins of the Music Business – Charlie McCreevy.” February 14, 2008; Nikki Tait, “EU Push to Extend Copyright of Musical Performers,” *The Financial Times*, February 15, 2008; Karen Attwood, “EU Wants Standard 95-Year Copyright for Music,” *The Independent*, February 15, 2008; David Gow, “Extend Performers’ Copyright to 95 Years, Says EU Commissioner,” *The Guardian*, February 15, 2008; David Charter, “Sir Cliff Richard Pins Hopes on Law that Will Keep Cash Rolling in until He’s 113,” *The Independent*, July 17, 2008.

¹⁰⁰¹ Martin Kretschmer, “Copyright Extension Will Benefit Few,” *The Financial Times*, February 18, 2008.

¹⁰⁰² *id.*

Chapter 4 and has produced many repercussions on diversity, creativity, entry barriers to the market, and viability of the music market overall. Such behaviour leads to a situation where small business is not sustained on a larger scale. Moreover, instead of providing an adequate form of protection to artists, copyright law quite often has had the opposite effect, with artists having to “...bargain with more powerful firms than they would have to, were copyrights weaker and of shorter duration”.¹⁰⁰³ Thus, if an artist is rejected by four majors or does not want to accept their ‘take it or leave it’ contracts, the only way out is in the independent labels.¹⁰⁰⁴

The resulting majors’ market power gives rise to the anomaly that independents release 80 percent of music available whilst the 20 percent released by the majors account for most of the sales and profits in the record industry. The high concentration of copyrights in the record industry is a fact but there are steps that can be made to reduce the power of the majors. Independents can and should play their part in minimising the problem of the described vicious circle. It is unfortunate that their trade bodies cannot see that, and instead support copyright extension. It can be argued that reversal of the copyright after an exploitative fixed term back to the artists¹⁰⁰⁵ could diminish the vicious circle problem. In this respect a ‘use it or lose it’ approach has been suggested, e.g. if copyright holders do not make a work available for public access for a period of 2 years, the rights would revert to the artists.¹⁰⁰⁶ This change would enhance competition and cultural diversity and bring greater benefits to creators, artists, and consumers. Another solution to diminish the effect of the described vicious circle would be to grant the copyright in sound recordings to those artists who have recouped the costs involved in those recordings from their royalties. In this case, those artists could license the sound recordings back to the record company for an additional amount of money. Such a move is, however, unlikely to be implemented in the near future, as both major and independent labels would probably resist it.

Competition law regulators too have a role to play in diminishing such high copyrights concentration in the hands of the four majors, as it was competition law that has allowed such power to be wielded by this handful of companies in the first place. Consolidation

¹⁰⁰³ Towse, *supra*, n. 485, at p. 99.

¹⁰⁰⁴ Interview with Mike Batt, *supra*, n. 343.

¹⁰⁰⁵ *Record of the Day*, “FAC Backs EU Preliminary Decision not to Extend Copyright on Sound Recordings.” March 31, 2009.

¹⁰⁰⁶ *Music Managers Forum*, “Music Managers Forum Submission to the Gowers Review of Intellectual Property.”

is not a problem in its own right, how the majors behave in the market is what does matter, and as Chapter 4 illustrated, majors do take advantage of the market power they wield. As opposed to the arts, which seek direct government support through subsidies, record companies seek indirect support through copyright law and its proposed extension. Competition law is the only way to stop the ever-increasing desire to merge and grow exponentially. Striking the right balance between the encouragement of competition and monopoly rights granted by copyrights is extremely difficult, but steps in this direction should be made. Some scholars, particularly cultural optimists, argue that “the freer the market, the better”.¹⁰⁰⁷ However, as illustrated in Chapter 4, a more open market structure may lead to the abuse of the situation.¹⁰⁰⁸

The present study has demonstrated the need for further empirical contributions to be made. The ever-changing nature of the record industry, particularly in the digital age, will necessitate relevant changes in the law. It is the hope of this author that future research improves on the measures between diversity and concentration and adds further insights to both the research of cultural industries and the necessary changes in competition law to take the cultural issues on board.

¹⁰⁰⁷ Towse, *supra*, n. 54, at p. 122. See also Cowen, *supra*, n. 57; and Keith Acheson and Christopher Maule, “Understanding Hollywood’s Organisation and Continuing Success.” *Journal of Cultural Economics* 18, no. 4 (1994/95): 271 – 300.

¹⁰⁰⁸ Towse, *ib.*

Glossary

Advance - is an up-front amount of money paid to an artist to deliver a recording that is later recouped from the artist's royalty. The advance is a form of loan from the record company.

A&R - is an acronym for Artist & Repertoire, akin to Research & Development in technological industries. A&R departments are the key feature of the industry because they search for new talent and genres, marry the desired content with the artist, and are responsible for the development of the artists on their roster.

Campaign Price / Discount - is a discount that a record company applies to a certain sales' campaign in retail.

Compilation - is a record that contains songs by different artists.

Concentration - is a term used in economics to describe market structure. A high level of concentration signifies that the market is controlled by a small number of participants or gatekeepers. In this case, the market is described as oligopolistic, i.e. the situation where firms are in the position to control the output and prices in order to maximise their profits.

Cover Record - is a new version of a previously released song by a different artist.

Deletion (Deleted Works) - is a record industry term referring to the removal of a record from a label's official catalogue. Deletion usually happens as a result of a decline in sales because distributing the record becomes no longer profitable.

Horizontal Integration - involves the same stages of production process, e.g. mergers between the existing firms and acquisitions of smaller competitors. It allows firms to increase their market share, and consequently their profits and market power.

File Discount - is a general discount negotiated annually and which impacts all albums sold to a particular customer.

Foreclosure - is the practice exercised by the dominant company that denies or limits proper access to the market, the aim of which is to extend the company's market power.

Invoice Price / Discount - is the record company's initial charge to the dealer. Therefore, an invoice discount is the deduction from the face amount of an invoice, made in advance of its payment.

Licensed-in Product - is a product (album) that was licensed to a record company (normally major) by another record company (normally independent label) for marketing and distribution.

List Price / Discount - is the record company's price, but very few buyers actually pay this price. The list price puts a ceiling on the retail price that can be charged and its main role is to define product categories for albums.

Maverick Firm - is a powerful firm that can drive competition in the market.

Publisher - is a company that acquires rights to music and its exploitation.

Published Price per Dealer (PPD) - is the amount the retailer buys the CD for.

Retrospective Discount - is an end-of-year bonus, where rebates are negotiated with customers on the basis of the turnover in the preceding year.

Roster - is the number of artists signed to a label.

Sampling (digital) - is the process of taking a part, or sample, of a song and reusing it in a different song. This process can be very expensive, as quite often two clearances have to be obtained by the sampler, i.e. copyright clearance in the sound recording (normally obtained from a record company) as well as copyright clearance in a musical composition (normally obtained from a publisher).

Second Request - is a process by which US competition authorities (the FTC and Antitrust Division) request more information and data about a proposed merger or

acquisition, if they believe that the new entity will impede competition in a given market.

Soundtrack - is a recording of the musical composition for a film.

Sound / Master Recording - is an original recording, from which copies are made.

Sunk Cost Industry - is an industry where costs are incurred and cannot be reversed, i.e. sunk costs are unrecoverable past expenditures.

Vertical Integration - allows firms to improve their supply chain efficiency, it involves different stages of production process, and e.g. when a major record company acquires CD manufacturing, distribution, and marketing facilities.

List of Abbreviations

A&R – Artist & Repertoire
BPI – British Phonographic Industry
CC – Creative Commons
CD – Compact Disc
CDPA – Copyrights, Design and Patent Act
CFI – Court of First Instance
ECJ – European Court of Justice
ECMR – European Community Merger Regulation
EP – European Parliament
FTC – Federal Trade Commission
GATT – General Agreement on Tariffs and Trade
GDP - Gross Domestic Product
GVA - Gross Value Added
IFPI – International Federation of the Phonographic Industry
ISP – Internet Software Provider
LP – Long Playing Record
MCPS-PRS – Mechanical Copyright Protection Society and Performing Right Society
RIAA – Recording Industry Association of America
OFT – Office of Fair Trading
SME – Small & Medium Enterprises
SIEC – Significant Impediment of Effective Competition
SLC – Substantial Lessening of Competition
TRIPS – Trade-Related Aspects of Intellectual Property

Questionnaire

1. What is an independent label?
2. What was your motivation for setting up an independent label?
3. Do you think there are differences between majors and independents?
4. Do you think that the romantic version of an independent label is being eroded these days, and is it all about profit-making even for independents?
5. Do you think that independents care about cultural diversity more than majors?
6. Are independents eroding the monopoly of majors?
7. What is your attitude towards the term extension of copyright in sound recordings? Who will benefit from this: labels or artists? And why do independent labels support the extension?
8. Are there any aspects of majors' behaviour that impact negatively on independents?
9. Are there any aspects of majors' behaviour that impact positively on independents?
10. What do you think was the main reason for the merger between Sony and BMG?
11. Should Impala have opposed the SonyBMG merger?
12. Do you think that the recent victory of Impala in the Court of First Instance will change anything for the independents?
13. Do you feel the record industry has to be regulated (if so, by whom)?

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